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# OPINION AND COMMENT

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# OPINION AND COMMENT

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# The British Loan

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THE United States Senate has been debating this spring whether our government should loan the English government 3,750,000,000 dollars. Although that would run our part of a major war for only two weeks, it is still an awesome amount of money. It is roughly the equivalent of all our exports in 1940, *or* the total wealth of Tennessee before the war, *or* all the passenger cars in the country 13 years ago, *or* 75 large boxcars stuffed with $1 bills, or a stack of $1,000 bills over half a mile high. It is about the size of one of our Liberty Bond drives of World War I, which means it is too big a transaction to be handled readily by a private banking house or probably even a group of them. It is being sought by a nation which defaulted on the last big loan we made. The loan would be made by our government out of taxpayers' money, which means that if the United Kingdom should default again it would come out of the pockets of the people of the United States. Yes, all of us have an interest in this loan.

First of all let us look at the terms of the loan and see what the United Kingdom gets and what we get and then decide whether it is a fair exchange. Second, let us see why the United Kingdom needs the loan so badly and then consider the arguments for and against our making the loan. And third, let us see what the consequences would be if we refused the loan. We can then come to a reasonable conclusion as to whether the loan is advisable or not.

## Terms of the Loan

Secretary of the Treasury Vinson and the Earl of Halifax agreed to terms last December 6, and both houses of Parliament accepted those terms by a large majority within two weeks. When and if our Congress likewise accepts them, the loan will go into effect.

Under the terms of the loan the United Kingdom will receive a "line of credit" of $3,750,000,000 to be drawn upon any time she needs it during the next six years, that is, until December 31, 1951. She will presumably borrow at the rate of about $600,000,000 a year. During this six-year period she will pay no interest at all on the loan. After 1951, she will pay 2 per cent interest and a 50th of the principal each year for 50 years. The transaction will be completed at the beginning of the 21st century. If during this period British imports fall below the 1936-38 average, we will waive the interest for as long as that condition lasts. In addition to the "line of credit," the United Kingdom is to have $650,000,000 of postwar lend-lease and surplus war materials left in Britain, to be paid for under the same terms. What all this adds

up to is that the United Kingdom will be receiving $4.4 billions, payable over 56 years, at a net interest rate of 1.6 per cent, which is a lower rate, on the average, than our national debt carries.

What does the United States get in return? We hope we get our money back and we hope we earn the gratitude of the English. Neither result is certain. If that were all, it would be highly questionable, because of the state of our own finances, whether we should make the loan. But the English have made some valuable concessions which make the whole transaction appear much more attractive. What are these concessions?

(1) The United Kingdom will eliminate within one year controls over the so-called "blocked sterling balances." That needs further explanation. At the beginning of the war the United Kingdom needed all the American dollars she could get her hands on to buy war supplies. Under our cash-and-carry legislation of that time we were asking "cash on the barrel-head" for all we sold. The United Kingdom made an agreement with all her dominions except Canada, with India and Egypt, and with her colonies, protectorates, and mandates, that whenever they sold goods to the United States and had dollars coming to them, they would turn those dollars over to her in exchange for pound sterling credits. The United Kingdom then used those dollars to buy needed war supplies from us. The various dominions either did without, or used the sterling to buy English goods, or let the English government buy American goods for them in some cases. In addition to taking over as many dollars as possible, the English purchased from their dominions and their colonies vast quantities of supplies as well as valuable services. These were also paid for with pound sterling credits. In the course of the war some $14 billions of such sterling credits or balances were built up. To this must probably be added $4 billions more for the postwar reconstruction period. India alone has $7 billions coming to her. The dominions and colonies can collect in only one way from the United Kingdom — by spending those balances to buy English goods. Those balances are "blocked" — Britain will not, in fact cannot now, exchange those pound sterling credits for dollars or pesos.

Let us look at the basic problem of the blocked sterling balances by using an everyday analogy. Suppose you sold your services or the merchandise you happen to make to a local department or general store and received most of your pay in the form of a store credit. Where would you be obliged to buy your personal and house supplies? Obviously at that store. You might prefer to get some supplies at another store but you simply could not afford to do it. Needless to say, if that were done on a large scale, the trade enjoyed by the other stores in town would decline. England is now in the position of the credit-paying store in that example; this country is in the position of a competing store.

If we approve the loan, the United Kingdom will be able to

abandon the blocked-sterling-balance system. Payments will be made on a few of those balances. Some of them will be put on a long-term loan basis; some will be scaled down; and a large part may be cancelled on the ground that if we could forgive the English nearly $17 billions of lend-lease balances, the dominions and colonies could do the equivalent, that is, cancel credits arising from the sale of supplies sold to England to fight the war. The important consequence of all this would be that then the United States would again be able to trade much more freely with parts of the world which used to take 25 per cent of our foreign trade, or about $1 billion of our exports annually.

(2) Within one year the United Kingdom will eliminate all but a few of the exchange controls and import restrictions affecting trade with the United States. Formerly there were definite limitations on the types and amounts of goods which Englishmen were permitted to import into England. Most of those limitations will now end. Under the Bretton Woods agreements, they might have continued for three to five more years.

(3) The United Kingdom will join with us in modifying tariff barriers and empire preference rules. When in 1930 we passed the Smoot-Hawley tariff, which gave us the highest tariff walls in all our history, the English retaliated in 1932 by establishing empire preference under which Britain and her dominions impose lower tariff duties on one another's goods than on goods from a nation outside the empire. Britain is vaguely committed to revise her tariff by the Atlantic Charter; she will be specifically committed to do so by the terms of the British Loan.

The consequence of these trade concessions is that much of the world is thrown open again to multilateral trade, and bilateral trade is largely eliminated. In plain English, that means we trade more on a money basis again and less on a barter basis. Trade is necessarily reduced when we make agreements with various nations to take just as much of their goods, and no more, as they take of ours. But let us use a familiar analogy again. How much less trade would you have in your town if you conducted business on a barter basis; if the lawyer, heating engineer, or contractor could trade with one another only to the extent that they were able to exchange services? The removal of restrictions arbitrarily channeling commerce in this way is greatly to be desired. World trade should increase as a result.

In short, Britain gets a line of credit on easy terms; we get valuable trade concessions. Who is getting the worst of the bargain? In a fair trade no one need feel "stung." It is often a good sign if both parties are satisfied or if both are dissatisfied. In this case both we and the English are finding some fault with the deal. That is a hopeful omen.

They should not feel injured because we refused an outright grant of $6 billions as a sort of deferred lend-lease, which is what the British wanted at first, or because we in-

sisted on charging interest on the loan. They should not want to be objects of charity: they should want to keep their self-respect by carrying out the transaction in a businesslike way. They have no real grievance because they will now have to ask the dominions to treat the blocked balances like a lend-lease transaction. On the other hand, we were not out-bargained because we failed to pick up a variety of other concessions along the way. A Wyoming senator recently wanted a promise not to dump wool on us; others have asked for cotton concessions, airport concessions, etc. We could not expect everything. We got trade concessions and, it may be noted, we did get valuable air concessions at the Bermuda Conference this winter. Of course we could be hurt if the British should default on their loan and then welch on the agreement. The welching on the agreement would perhaps be the greater loss.

### Why England Needs the Loan

Many people want to know why the United Kingdom needs this loan so badly now. This is not difficult to explain. Before the war Great Britain imported nearly $2 billions more of goods than she exported. She made up the difference (a) by interest and dividends she received on overseas investments, accounting for $1 billion; (b) by payment for shipping, amounting to $500,000,000; (c) by fees from banking, insurance, and other services, amounting to $200,000,000. As a result of the war the United Kingdom cut down on her exports in order to produce war materials and provide for home consumption; she sold many of her overseas investments so that now the income from those is half what it used to be; she lost nearly a third of her shipping; she lost some of her banking and insurance business; and she had to dispose of a considerable part of her gold reserves. During the early days of the war she used the proceeds from sold investments and from gold to buy supplies from the United States; later the lend-lease program provided war supplies and the English concentrated still more on domestic production.

Now that the war is over, lend-lease has ceased, the holdings of investments and gold are reduced, many factories have been bombed out, and others are equipped to manufacture only war supplies or their equipment has become obsolete. England's European market is poverty-stricken, her Asiatic rubber monopoly is gone, her dominance in shipping is past, and *YET* she needs imports of food, raw materials, machinery, and other supplies to get back on her feet again. She needs more than she ever did; she has less than before to offer. When her factories are retooled and rebuilt and her European and other markets have recovered from the worst effects of the war, the United Kingdom expects to be able to make ends meet again. But in the meantime she needs a lift; she needs it badly. In coming to the United States for aid, Englishmen have had to swallow a good bit of pride. But it was the only real solution to their present difficulty. As the late

Lord Keynes told the House of Lords in December, "Do the critics really grasp the alternative? The alternative is to build up a separate economic bloc which excludes Canada and consists of countries to which we already owe more than we can pay on the basis of their agreeing to lend us money that they have not got and buying from us goods we are not able to supply."

Many people ask why the English have to get the loan from us. Why not go to the dominions; why not borrow from the Monetary Fund and the International Bank; why not go to the Export-Import Bank? The answer to these questions is that they actually need more than $3,750,000,000 and they are getting some of their additional needs from Canada and perhaps other dominions. As for the Monetary Fund and the International Bank, the first is not intended to provide such long-term loans as the United Kingdom needs, and the two together could not loan more than a fraction of what is needed. If the United Kingdom is to borrow to carry her over the hump ahead, this country is the only one in a position to help.

To all that you may say, "Very well, but this country had better stop spending money like a drunken sailor and live within its income. After all, the United Kingdom was fighting for herself more than for us. She has frequently driven a hard bargain in the past and may not be as badly off even now as she pretends to be. We contributed about $17 billions in lend-lease during the war. That is enough. We have to look out for ourselves."

Very well, let's be practical about this; let's weigh the arguments against the loan and for the loan and then each of us can decide for himself which arguments are stronger and whether the loan is a worth-while project. First, we shall examine the arguments against the loan, then those for it.

### Arguments Against the Loan

One argument frequently heard is that by making the loan to a Labor government which is taking over certain English institutions like the Bank of England and the coal mines, we shall only be subsidizing Socialism. That is not a strong argument. Those who make it ignore the methods by which the Bank of England and the coal mines are taken over. The government merely exchanges government bonds for Bank of England or coal mining shares. It is not necessary to have a foreign loan to do that. It has nothing to do with a foreign loan. About all you can honestly say is that the loan will promote more prosperity and thus keep the Labor government in office longer. In that sense only does it promote Socialism.

A second argument is that we should only be pulling the Englishman's chestnuts out of the fire for him, merely saving the Empire for the King and Churchill, and all the others. Those who take this line sometimes add that the British are "land poor" — they have more property in this world than their income can maintain and it is about time they gave some of it up. There is no single answer to this objection, for it is largely true. We would be help-

ing to save the British empire. However, we may well pause to ask ourselves whether it is not to our interest to bolster the strongest ally we have. Judging by Russia's behavior in the last few months we need a strong outpost or a powerful friend off the coast of Europe. As for the argument that Britain has too much property, probably she has. She did well recently to offer India her freedom at last. Also we might have been well-advised to take a mortgage on some of the British West Indies as security for the loan. Perhaps we did not do so because our island possessions to date have been more of a liability than an asset.

Other opponents of the loan say that if the British get it her manufacturers will only continue to use their antiquated methods until the money is gone, and that the sooner they are jarred out of their rut the better. There may be something in this argument, although this war and present conditions have been quite a jar. And in many cases it is not a question of scrapping old equipment but of rebuilding bombed-out factories from the ground up.

Another argument is just the opposite of the third, namely, that we shall only be setting up a keen competitor. We probably shall encounter some English competition. If you are a producer of, say chinaware, you will not like that, but if you are a buyer of it, you should like it. However, the chief answer to the argument that we shall be setting up a competitor is that it is based on the false economic assumption that there is only so much business available. That is not true. The more we or the English make and have to offer, the more buying power we have and the more we can buy. The world prospers only as its parts prosper. Furthermore, we cannot hope to sell to England if we are not willing to buy from England, and there are plenty of Americans who want to sell to England.

Some object that the English by entering our market at present and bidding for our supply of goods would promote further inflation in this country. There is real danger of that. For the most part what the English want is food, raw materials, and machinery and there are adequate stocks of most of these in this country. Holding down food prices would seem the major problem. The English are not so much in need of the scarce manufactured articles which many of us seem most anxious to buy.

Another protest is that France, Russia, the South American countries, and many others will also demand loans. This is already happening. France has asked for a loan of $2.5 billions; Russia has requested $1 billion; China, Chile, and others have talked of loans. One authority has estimated that we shall be asked to lend as much as $20 billions. Some of these loans it may be difficult to refuse without causing hard feelings, especially if we have already accommodated the English. Yet it would be courting financial disaster to accede to all these requests. Foreign nations borrowed but could not repay half this amount in the 1920's. The lines of least resistance are either to lend to all or to lend to none. Probably the wiser but

far more difficult policy is to consider each request on its merits. If we should lend to the United Kingdom it will be difficult to refuse France. However, we can and should demand territorial security for such loans. Some loans can be handled through the Export-Import Bank — that is probably the way the Russian loan will go; others should be referred to the International Bank; and still others, probably the majority, should be turned down, or at least turned over to private investment houses. Admittedly this selection among nations is a difficult aspect of the problem.

Then there is the objection that the interest rate is too low. We are borrowing at 2 to 2.4 per cent for long-term loans and lending at 1.6 per cent. The Export-Import Bank gets 3 per cent and sometimes more. Despite the English plea that they are unable to bear carrying charges beyond a certain figure, the low interest rate is hard to excuse.

Finally there are the pessimists who prophesy that we shall never get it back. "We didn't before and we shan't this time," they exclaim. And even if we do, they add, a debtor is never a good friend. One answer to all that is that last time the loan was for war supplies, this time it is for postwar needs. This time we gave them the war supplies under lend-lease arrangement. England has a good record on peacetime loans. We should get it back. As for a debtor not being a good friend, there is much truth in that, but if a creditor has a worse friend than his debtor, it is the former friend he turned down completely.

Those are most of the usual arguments against the loan. Some are quite false; some are contradictory; some are valid. The strongest ones seem to be that the loan may promote some inflation here; it will be hard to refuse loans to other nations; the interest rate is low; and our own finances are not in good enough shape for us to help other nations extensively. What are the arguments for the loan? They are few, simple and, to many, persuasive.

### Arguments for the Loan

We are living in a dangerous world despite the UN; in that world capitalism and socialism may in time come into open conflict. We all hope not, but it is quite possible. If that should happen, we would need strong allies. By character and temperament the English are the most likely and strongest allies we could have. They are in distress and have asked us for help, help on reasonably businesslike terms. We would be wise to give that help. Otherwise England will weaken more, Russia will advance, the hour of conflict will approach, and we and our ally will be in a weaker position.

Even if you assume that the UN will successfully prevent future wars, you may be interested in cutting out many restrictions on world trade. By that is meant the elimination of bilateral trade agreements, barter agreements, import quotas, blocked balances, preferential tariffs, and all the other fetters to a freer world trade. Largely because of

various trade restrictions, world trade in 1937 amounted to only half of the 1929 figure. Both were prosperous years. Let us do away with such restrictions when we have the opportunity. The English agree to abandon most of theirs if we make the loan. England and this country are the two leading nations in world trade. Others are bound to follow our lead. The Bretton Woods proposals were forced through last year partly with the propaganda that they would restore freer world trade. Actually the British are making more and earlier concessions to get this loan than they made under the Bretton Woods program. We hope that our postwar world trade will amount to $10 billions — it was $7 billions in prosperous 1937. It cannot reach that figure unless trade barriers are scaled down. This loan will help greatly to do that.

### Conclusion

But suppose that the Congress refuses to ratify the loan. What then? Our share of world trade will be smaller. Bilateral trade agreements, import quotas, etc., will increase in number and complexity. Such restrictions prepare the way for Fascism or Socialism. Hitler's magician, Hjalmar Schacht, did much to develop bilateral trade in the last decade. Multilateral trade is much more in keeping with Capitalism. Also we should probably witness an ever-weakening United Kingdom and an ever-advancing Russia.

In summary, while there are strong arguments against the loan there are powerful ones in its favor. The facts that the loan will strengthen our best ally and make for freer world trade have convinced this writer that the loan should be made.

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**Toward Economic Balance.** — There is substantial basis for the impression that monetary conversion to war is easier than physical conversion but that monetary reconversion to peace is more difficult than physical reconversion. The primary reason is that monetary machinery performs a much larger part of the total economic job in time of peace than in time of war. Moreover, money created to finance the war remains at its close to exert its full and permeating effects, while the change-over of physical plant has a relatively clear-cut beginning and end. . . .

It should not be surprising that relegation of monetary cost to a secondary role during a long and costly war should create difficulties for the reconversion of the monetary system to peace. It is extremely difficult to develop a policy and program that will minimize the frictions incident to re-establishment of money in its full and useful role in the economy. An attempt to do so overnight could easily result in disaster. — From the *Business Review,* Federal Reserve Bank of Philadelphia, April 1, 1946.

# Agricultural Policies of the United States

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In recent years the government has had a positive and active farm program. This program has not been static but has changed from time to time. In a brief review it is possible to sketch only a few of the central features. Two ideas have come to be of central importance: conservation and parity. Conservation means to preserve, to protect, to keep resources from being wasted. Parity simply means equality. These two concepts run through the tangled web of programs which have evolved over the last twenty years. Both are widely accepted as desirable goals, not only among farmers but by the public at large.

The economic history of the United States is largely the story of the occupation and settlement of the large area of land constituting the United States — some two billion acres. Resources have been exploited and in many cases exhausted. To this end we developed our transportation system and built our towns and cities. They were paid for out of the wealth created by the various ramifications of this process. It paid the individual who owned a piece of property to draw on its natural resources and thereby to acquire other goods and services he needed. This process raised his standard of living and in some cases made him wealthy. It also paid an economy short of capital to convert natural resources into usable capital goods. By this process we built our roads, schools, railroads, towns, cities, and factories. But there is obviously an end to this kind of exploitation. You cannot always draw on nature's bank. Some day the balance is exhausted.

In farming it was discovered that certain elements needed for effective use of the soil resources were either absent or needed to be replenished after a period. Without adequate supplies of these elements in the soil, effective use could not be made of the other elements in the production of crops, including the chemical elements still available in adequate amounts, water, organic matter, sunshine, and the needed applications of labor and capital (seed, machinery, and motive power). In Illinois this situation led to the development of the Illinois System of Permanent Agriculture based on applications of limestone, phosphates, and the growing of clovers. More recently potash was discovered to be a limiting element in certain areas. The addition of these either help to maintain the fertility and crop yields or to restore these to their original level, or to an improvement in yields above the original level. This process can better be designated as intelligent use than as conservation, as it tends to use up whatever surplus elements may be present. Nevertheless, it can

furnish a basis for a permanent agriculture so long as supplies of surplus mineral elements can be found to be moved to the lands needing treatment. A considerable part of the educational work with farmers in Illinois is concerned with spreading knowledge concerning more intelligent use of our soil resources. The most recent development has been the setting up of county soil-testing laboratories in most of the county farm advisers' offices throughout the state.

A more insidious type of wastage of soils than loss of fertility elements is the loss of soil by erosion. That this process steadily goes on is evident to anyone who observes the muddy color of our streams after a rainstorm even in the more level sections of the state. This color is merely soil particles carried off by water in motion. A more graphic picture of the situation can be gained by flying over any section of the country. This situation was dramatized in the minds of many people by the dust storms of 1934 which blackened the skies even over the eastern parts of the country. These dark clouds were merely soil particles picked up by the wind. To keep our topsoils we need to prevent, as far as possible, the moving about of soils by either water or air in motion. This topsoil which makes possible the food we eat is our most valuable national resource. It took long periods to create it, but it may be swept away by a flash flood resulting from a heavy cooling shower on some hot August day.

Such wastage can be retarded by good farming practices which keep up the organic matter in the soil, by keeping more of the land covered with close-growing hay or pasture crops, or by various specific conservation practices such as terraces to break the flow of water down slopes, grass waterways in the drains and gullies where water runs, or contour farming where the rows of cultivated crops follow level contours so as to break the flow of water.

### Federal Conservation Program

In addition to the regular educational work with farmers which centers in the Extension Service in Agriculture of the University of Illinois, the programs of two Federal agencies are now mainly concerned with conservation: the Agricultural Adjustment Agency and the Soil Conservation Service. The AAA was set up to administer various farm programs which have been in operation since 1933. During wartime its major function was to administer a system of payments to individual landowners for soil-building and conserving practices which partially reimburse farmers for their costs in connection with such practices. The maximum amount per farm is limited to a stated amount per acre of cropland. The farmer or landowner may go beyond the amount for which he is reimbursed; in fact, the government will not finance a very extensive program. Some $300,000,000 is made available annually for such payments, or an average of something less than 50 cents an acre of cropland. Earlier crop control programs of the AAA tended to stimulate larger acreages of clover and other close-growing

leguminous crops. These payments stimulated many landowners to try out and to adopt various conserving or soil-building practices and thus have had a desirable educational effect. In Illinois, the payments are largely made for applications of limestone and phosphate, although in some sections of the state they are also made for specific soil-conserving practices such as contour farming. Some of these latter types of practices permit farmers to earn "unlimited payments," i.e., payments beyond the base of a fixed amount per crop acre.

The justification for all these payments is that the maintenance of the basic soil resources goes beyond the interest of the individual landowner and extends to all the consumers of food — both the present and the future generations. These practices admittedly pay the individual farmers, but they also help maintain our food-producing reserve in which we are all interested. The only agency that represents the entire public is the Federal government. So it is a Federal program. Administration, however, rests with local farmers at the state, county, and township levels.

The Soil Conservation Service directs its energies mainly to the erosion aspects of soil conservation. It maintains a staff of technicians who plan conservation measures needed under particular circumstances and help farmers to get these practices into use. It is a planning, educational, and service agency. It works through soil conservation districts established under state laws by the vote of local landowners and administered by boards of landowners who lay down the general program under which the Soil Conservation Service technicians operate. This Service has probably been most successful in Illinois in the areas with rolling lands and loess soils in the western part of the state, which are very responsive to better treatment and are subject to visible erosion. Adapted programs will undoubtedly be worked out for other sections of the state.

Conservation was hindered by our wartime production program. We needed food — a great deal of it — then, and not in the future. Accordingly, goals for crops were set up, which meant very heavy cropping systems — larger acreages in corn and more especially in soybeans. The aim was a cropping system which would not do "irreparable damage" to the land. Some of the damage which occurred did not meet this test and must be looked upon as one of the costs of war. Illinois lands were never so heavily cropped as during the war, partly in response to patriotic impulses, partly in response to the fact that it paid to farm hard. Illinois is one of the great reserve granaries of the world. In World War I the state sharply increased its acreage of wheat, then needed as wartime food; in this war it greatly increased its acreage of soybeans and, to a lesser extent, of corn. The principal reconversion program in this state will be to go back to a more rational cropping system with less soybeans and corn and more legume hay and pasture. The longer world-wide food shortages cause high prices for

basic crops, the longer the process of reconversion will be delayed and the more necessary a genuine conserving system will be. The problem has also been accentuated by hybrid corn, which yields more heavily than the older types of corn and therefore drains more heavily on soil fertility.

Not only our wartime developments but also the trend of events over the last twenty years indicate that conservation will be a main element in our postwar farm program. Just what angle will be emphasized is not certain. Established agencies generally continue and make their particular contributions to the broad policies which meet with public approval. Certainly the most serious aspect of the conservation problem from the public standpoint is the actual loss of soils through erosion, and first consideration should be given to practical measures which will slow down this process. Nothing can prevent it. As geological records clearly demonstrate, running water and strong winds will always move some soil. But the process can be slowed by widespread adoption of certain practices directed toward conservation of our basic resource — agricultural land. Federal policy for agriculture will certainly continue to be directed toward soil conservation and with widespread public approval.

### Parity Measures

The second major objective of farm policy has been parity or equality between farm and non-farm people. This goal also has met with widespread approval among non-farm as well as farm people. The program hinges about prices and income. Farmers know that prices play a major role in determining their incomes. Farm income is determined by two major components: volume of production and price. Total farm production is much more stable from year to year than are prices of farm products, and many of the fluctuations in farm incomes are caused by changes in prices. Throughout the history of this country farmers have taken an interest in monetary matters which they deemed to be important in price behavior. In the long period of declining prices after the Civil War "Greenbackism" and "free silver" were important rallying points for farmers in periods of low prices. The real cause of this interest was the falling prices which steadily cut the ground out from under farm incomes. Farm prices rose from the late 1890's to the beginning of World War I and were then inflated along with other raw-material prices during and immediately after the war. In 1920-21 the farm price level collapsed. Caught with land purchased at high prices and with increased costs, many farmers were subjected to a squeeze which led to agitation for relief. The trend of thinking was not toward monetary proposals but toward specific plans to bolster prices of individual products, and to attempt to apply some of the devices of "administered prices" which were widely used in connection with industrial prices, farm machinery for example, to prices of farm products. To this

end farmers sought governmental assistance.

Shortly after the price debacle of the early 1920's, two businessmen connected with a farm machinery company in Moline, Illinois, issued a pamphlet called "Equality for Agriculture" in which they set out the doctrine of parity. Their names were George Peek and Gen. Hugh A. Johnson. Farm organizations took up the idea, and specific devices which it was hoped would accomplish the desired objective were written into what was known as the McNary-Haugen Bill. The basic elements were (1) a two-price system, one for the American market, and another for the export or other diversionary market; and (2) an equalization fee for meeting the costs incurred in selling a part of the supply in a lower-priced market. This measure twice passed the Congress and each time was vetoed by President Coolidge.

In 1929 the Federal Farm Board was set up under President Hoover's administration. It was given an appropriation of $500,000,000 to use for various purposes, including stabilization of the prices of farm products. Mr. Alexander Legge, then head of the International Harvester Company, was made Chairman of this Board. First by loans and then by outright purchases, particularly of wheat and cotton, the Board attempted to stem the tide of world-wide deflation in prices of staple products, which was a prime factor in the major depression of the 1930's. The Board failed and was liquidated in 1933, after President Roosevelt's election.

There was then set up an Agricultural Adjustment Administration which went through a number of stages. Among the tools used by the Administration were acreage control; quotas for hog production; use of processing taxes (an example of the old equalization fee), which were declared unconstitutional; marketing quotas for some items; and direct payments to farmers for acreage adjustments and conservation practices and as "parity payments" on basic crops such as corn, wheat, and cotton. Also an extensive system of commodity loans was set up under the Commodity Credit Corporation which, in effect, took over the commodity stabilization program of the Federal Farm Board. Further, a number of programs for diverting products to unusual uses were put into effect, particularly in connection with horticultural products. In connection with milk, market orders were put into effect in a number of the large markets of the country, establishing the basis for determining milk prices. In much of this program emphasis was on regulating supplies either through acreage or other controls or influencing the amounts coming on the market through the loan programs. All these production programs cost money, and large Federal appropriations were made to carry out various parts of it.

In all these programs parity was taken as standard. When the concept of parity moved out of the realm of discussion into that of action, a formula had to be set up to measure it. In general, purchasing power equal to that of 1910-1914

became the legally prescribed standard for parity. To determine the parity price of corn, for example, the average price in this 5-year period before World War I is multiplied by an index measuring the cost of goods bought by farmers. Later interest and tax payments were included in the multiplier but the costs of labor have not been included. For some products other periods were taken as the base, and for a number of products for which data were either not available or 1910-1914 was clearly inapplicable, averages for 1935-1939 were taken as a standard. Thus, for soybeans the "comparable price" which has the same meaning as the parity price used 1935-1939 as the standard.

Parity income was also set as a goal. This was defined as a net income to farm people on a per capita basis that bears the same relationship to income of non-farm people as existed in 1910-1914.

### Results of Parity Measures

How successful were all these programs in achieving parity? In 1940, the year before the United States went to war, farm prices stood at their 1910-1914 average and the index of the parity multiplier stood at 125. Thus all farm prices averaged 80 per cent of parity. The situation was a little less favorable in 1938 and 1939. In 1940 the parity income ratio stood at 79 per cent of parity when government payments to farmers were omitted, and at 90 per cent of parity when such payments were included. Thus, whatever else these programs accomplished, they did not result in parity prices or incomes in the period just before the war. Through the use of government payments they did transfer considerable money to farmers. Payments to farm operators amounted to $766 millions in 1940. Economists are generally agreed that the attempt to build up farm income by efforts on the supply side of the price equation will never be successful. Although the basic laws related to control of acreage of basic crops remain on the law books, many people would like to see less attention paid to the supply approach in the period after the war. These facts indicate that under the conditions of incomplete use of our national economic resources that prevailed in the period just before we became involved in the recent war, the program attempted did not succeed in getting either parity prices or income for farmers.

The war raised farm prices and incomes above parity. The nature of our agricultural programs shifted primarily to increasing production of needed products and to holding down price advances by ceilings. In order to get prices high enough to provide incentives to production and to keep down prices to consumers, a system of food subsidies was devised involving government payments of something over $1.5 billions annually. Most of this program is still in effect. Parity was still used as a standard: No ceiling could be set on a farm product below the parity price of the commodity and no support price could be below 90 per cent of the parity price. Likewise in our postwar program, which calls for supporting prices through 1948

f the war is officially ended in 1946, ınd for a year beyond 1948 for each year the official end of the war is ɔostponed, the standard is not less han 90 per cent of parity for each ommodity to be supported.

However, parity was not the real standard in our wartime program. It has become more and more gen- erally recognized that the present standard of parity for individual commodities is out of date. Fixed as they are at the more or less acci- dental relationships of the years 1910-1914, now over thirty years past, the standard could not help but establish bad relationships between ndividual items. Relative costs have changed; likewise some products have increased in public favor and others have diminished. Changes in costs are probably the more basic. Crop production has been mecha- nized, whereas no corresponding changes have occurred in connec- tion with methods of livestock pro- duction. We no longer produce grain for feed for horses and mules as a primary source of farm power. These are conspicuous changes but there are others. Hence the position which prices reached in relation to parity varied greatly.

In 1943, a war year, the prices of various farm products averaged the following percentages of parity:

| *Commodity* | *Percentage* |
|---|---|
| Hay | 67 |
| Wheat | 89 |
| Corn | 99 |
| Soybeans | 109 |
| Eggs | 111 |
| Hogs | 117 |
| Butterfat | 118 |
| Milk | 122 |
| Wool | 139 |
| Beef cattle | 140 |

Farmers increased production of corn and wheat at less than parity prices; but to get adequate produc- tion of livestock products, prices had to go well above parity.

### Recent Parity Proposals

As stated at the outset, parity and conservation are two goals of our agricultural policy. Just as conser- vation will be one of our postwar goals, so will parity. But there is increasing agreement that our pres- ent parity formula will not be ade- quate from now on. It simply does not indicate proper relationships among prices of individual com- modities. Bills to revise the standard are constantly coming up in Con- gress; most of these would raise the entire level of parity through inclu- sion of cost of wages in the multi- plier. This type of correction would not alter the basic defect of bad relationships between commodities now inherent in the formula for parity. It is hard to conceive that Congress will make the basic cor- rections that are needed, because each special interest group will re- sist lowering parity for the items in which it is interested. The situation is much like that of the tariff be- fore the matter of individual duty rates was in effect delegated to ad- ministrative decision by the Trade Agreement Act.

The American Farm Economic Association conducted a contest on farm price policy in 1945, offering $12,500 in prizes for the best paper submitted. The eighteen prize papers were published in the November issue of the *Journal of Farm Eco-*

*nomics*.[1] All the prize papers agreed that the present parity formula was out of date and must be revised; some would abandon it entirely. Various suggestions for revision were made. It is also agreed by many of these men that in order to accomplish the economic functions of prices in guiding production and getting goods consumed, greater freedom and flexibility in prices should be permitted than is possible under a system of attempting to maintain prices at a high ratio to an arbitrary standard. Conditions are entirely different in an industry like agriculture, in which production is continuous, from those in a manufacturing industry, in which production can be controlled and prices held rather constant. The question is not: Is is better public policy to encourage rigid inflexible prices or to have more flexible and variable prices? It is simply impossible to make an inflexible system of prices work in connection with agricultural products. No practical system of actually controlling output has been devised. Moreover, in the judgment of most economists flexible variable prices are more in the public interest than are rigid price structures.

Recognizing that the principle of parity will be continued, many people have suggested that prices of farm products should be allowed to fluctuate freely and that the difference between the actual market price and some standard — not necessarily the present parity formula — should be made up by direct payments from the government. These are called "compensatory price payments." A number of the winners in the contest noted above made this suggestion. Professor T. W. Schultz of the University of Chicago, in his book, *Redirecting Farm Policy*, a study made under the auspices of the Research Committee of the Committee on Economic Development, endorses this proposal. A committee of the American Farm Economic Association recommended: "The government should announce in advance a support schedule of prices for each agricultural commodity. . . . The Congress should authorize a flexible program to carry out the support commitments. Main reliance should be placed on direct payments to farmers of the *difference between the announced schedule and the market price*."[2]

Professor Working and the writer of the Department of Agricultural Economics, University of Illinois, have advanced an income proposal in lieu of price supports.[3] They feel that any system of price support will destroy the usefulness of prices in guiding production and consumption. But they believe that it is wise national policy to guard farmers against the full effect of price declines caused by the periodic stoppages of industry which we call depressions. Farmers will continue production; to do so is the nature

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[1] Published by the AFEA, of which Dr. Asher Hobson, University of Wisconsin, Madison, is secretary.

[2] *Journal of Farm Economics*, February, 1946, p. 396.

[3] *Illinois Farm Economics* (Department of Agricultural Economics, University of Illinois) December, 1945-January, 1946.

of their business, inherent in its basic characteristics. But when industry stops and foreign markets decline, farm prices fall and farmers are punished. Some people may argue that they should leave the farm, or they should curtail output. But long experience shows that farmers do not leave farming in depressions; they leave during periods of prosperity. Some five million people left farms during the recent wartime period of prosperity. Employmentwise, farming is a shock absorber in depressions. Moreover, the public does not want production of farm products reduced in depressions. People still need and want to eat. In fact, consumption of foodstuffs does not fall off in depressions. But prices do.

Working and Norton suggest as an alternative to a program of price supports and manipulation that farm income be supported. They would set a standard below which total per capita farm income would not be allowed to fall in relation to per capita national income.

They suggest a simple formula for calculating from available data the proportion of farm income in any year to national income. If the actual income falls below this standard, then they would have the government make up the difference. This would be distributed to individual farmers according to each farmer's gross sales counted in such a way as to avoid double counting certain elements of income. Thus if the total income in a particular year fell 10 per cent below the established standard in relation to national income and the farmer's gross sales were $3,000, he would get $300. This would be in effect an indemnity to him for continuing to produce needed products in a period when bad business, labor, or government policies have caused our economic machine to stall. Under the standard they suggest, such payments would be made only in periods of abnormally low farm income in relation to national incomes, such as 1921-23, 1930-32, and 1938-40. The actual standard of farm to national income would of course be set by Congress. Otherwise the plan would be largely one of administrative routine.

Under this plan farmers would be free to farm and to market as their judgment and resources permitted. Their incomes would be protected against the full effect of depressions to which the farmers' practice of continuing production does not contribute. It represents a different approach to the parity problem from the present program of attempting to maintain prices of individual products in relation to a more or less arbitrary standard.

One of the basic policies of this country has been freedom — economic, as well as political, and other types of freedom. Most people want to keep these freedoms. One of the fundamental advantages of the proposal of Working and Norton is that it would restore freedom to farm production and marketing. Three basic farm policies of this country would then be Conservation, Parity, and Freedom. Farmers, as well as other businessmen, need to remember that when they seek gov-

ernment intervention in their affairs they sacrifice a degree of their freedom of action. Farmers want parity and, as said earlier, the fundamental fairness of this concept gives it a widespread appeal. The program outlined above would give to farmers the greatest freedom to serve the public's needs for foods and fiber and at the same time afford them protection against the disastrous price declines for which their actions are not the primary cause. At the same time it would insure individual freedom of action not present in many of the plans which might be used in an attempt to achieve the goal of parity.

**Production Trend Upward.** — In the phenomenal trade figures, and in the urge to push production ahead in the face of all obstacles, is seen the working of the influences which have been counted on all along to pull business out of the state of confusion and disturbance. One influence is the pressure of unsatisfied wants and accumulated needs all over the world, not merely to repair destruction, but to supply even the bare minimum of daily necessities. Another is the influence of the accumulated money purchasing power. It was always to be expected that these two influences in due course would pull the situation off the dead center of uncertainty, and that as labor conditions settled and prices worked toward a new balance the accelerating forces would become effective again. — From the April letter of the National City Bank of New York.

**War Loan Financing.** — Between the First War Loan Drive, which formally began on November 30, 1942, and the Victory Loan Drive, which ended on December 31, 1945, this nation completed the largest war financing program in history. Total sales of government securities in the seven war loan drives and the Victory Loan Drive in the United States amounted to $156,893,000,000, of which nonbank investors, including individuals, insurance companies, savings banks and savings and loan associations, nonfinancial corporations, dealers and brokers, and government units and accounts, purchased $146,727,000,000. — From *Monthly Business Review,* Federal Reserve Bank of Dallas, April 1, 1946.

# Reconversion Wage Policy

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## Wartime Restrictions on Collective Bargaining

To understand labor-management disagreements over the wage issue since V-J Day, it is necessary to survey briefly the wartime restrictions imposed upon collective bargaining and wage adjustments by the government. The first of these restrictions came about as the result of the agreement of labor and industry, after Pearl Harbor, to refrain from the use of economic force to settle labor disputes during the war — the "no-strike, no-lockout" agreement — and instead to submit such disputes to the government for final decision. Pursuant to this agreement, the President established the tripartite National War Labor Board on January 12, 1942, to administer the no-strike, no-lockout agreement.

In June, 1943, the War Labor Board received legislative support through the enactment by Congress of the War Labor Disputes Act. This act provided that in connection with labor disputes "which may lead to substantial interference with the war effort, and cannot be settled by collective bargaining or conciliation," the Board was "to decide the dispute — by order which shall provide for terms and conditions to govern the relations between the parties which shall be fair and equitable to employer and employee under the circumstances of the case." Thus the use of the strike and the lockout as collective bargaining devices was prohibited for the duration of the war. In view of the fact that the strike threat is the only really potent weapon labor has, the importance of this restriction on normal collective bargaining procedures was evident.

From January to October, 1942, the sole function of the War Labor Board was the settlement of industrial disputes, and the prohibition of the use of the strike and the lockout represented the only serious restriction on free collective bargaining between management and labor. But in October, 1942, after Congress had passed the Wage Stabilization Act, the Board was given the additional duty of stabilizing wages for virtually all American industry, in both voluntary and dispute cases. While this law did not clamp a rigid freeze on all wages, it did restrict permissible wage adjustments to exceedingly small amounts. The reason for this restriction upon wage increases, of course, was to reduce the pressure of wages, both as a cost of production and as a source of purchasing power, upon prices. For the first time in our history, wage earners were told that they could not have a wage increase even though the employer was perfectly willing to give it to them. When it is remembered that wages are the very heart of the employment contract,

the magnitude of this restriction upon free collective bargaining is appreciated.

Under these wartime restrictions there was a strong tendency for both labor and management to dodge their responsibility for attempting to settle their disputes by collective bargaining, and, instead, to dump all their problems into the lap of the War Labor Board. One of the first tasks of the Board, therefore, was to protect itself against misuse of its powers as a substitute for *all* collective bargaining. The Board had to insist that it would not attempt to decide disputes between labor and management until the parties had exhausted all possibilities of settlement by collective bargaining. Granted that governmental interference and restriction in collective bargaining was inevitable in wartime, the Board insisted that such restrictions should be limited to the narrowest possible scope, and further that the Board should withdraw from the field of collective bargaining at the earliest possible moment. In short, the Board said that, despite the surrender of the strike and lockout weapons in collective bargaining, and despite the limitations imposed by the wage stabilization program on the scope of collective bargaining over wages, the parties must sincerely attempt to reconcile all their non-wage differences by collective bargaining without resorting to the War Labor Board. To enforce this policy, the Board frequently returned dispute cases involving a large number of non-wage issues, many of them trivial in nature, to the parties for settlement by collective bargaining. In other cases the Board laid down the general framework for settlement of dispute cases and returned the cases to the parties to fill in the details by bargaining.

To a degree not generally appreciated by the American public, the War Labor Board was successful in enforcing these wartime restrictions on the use of the strike and lockout and on unlimited wage increases. The number of man-days lost because of strikes during the war never exceeded ½ of 1 per cent of the number of man-days worked. This is truly a remarkable record. In the field of wage stabilization the record is also good. The average straight-time hourly earnings of all workers in manufacturing industries increased 55 per cent from January, 1939, to August, 1945. But 40 per cent of this increase in straight-time earnings came between January, 1939, and October, 1942 — before wage stabilization. Only 15 per cent of this increase came in the last three years of the war under the War Labor Board controls. In other words, there was a 40 per cent increase in straight-time earnings in the first three years of the war before wage stabilization, and only a 15 per cent increase in the last three years of the war under wage stabilization. And these last three years were the years of most extreme pressure for wage increases as the labor market became tighter and tighter.

### The Post-V-J-Day Picture

The collapse of Japan last August came very suddenly. The end of the

war found labor, management, and the Administration with no adequate program for the job of reconversion. In an effort to speed the transition of our economy from war to peace, the President acted immediately and boldly to lift many of our wartime controls over production, wages, and collective bargaining. The hasty and ill-advised action of the Administration in eliminating practically all the wartime controls over wage and collective bargaining last August, after three years of very strict controls, caught both labor and management totally unprepared to meet these peacetime responsibilities. For all practical purposes the War Labor Board was terminated last August with the lifting of the wage stabilization restrictions and the end of the no-strike, no-lockout pledge, even though its official demise did not occur until December 31, 1945. But unfortunately the emergency conditions which had made the War Labor Board controls necessary were not suddenly terminated with the arrival of V-J Day.

Labor's sudden release from the no-strike pledge and from the wartime restrictions on wage increases seemed an open invitation to exercise its economic power to gain sizable wage increases. Indeed, it would have been difficult to place any other interpretation upon this action by the Administration. The immediate impetus behind organized labor's new demand for major wage increases, however, was a rather general reduction in the wartime work week from 48 or more hours to 40 hours, with a consequent loss of take-home pay. Organized labor's general demand for a 30 per cent wage increase was, therefore, not just a figure plucked out of thin air for bargaining purposes, but instead it was based upon the approximate 30 per cent loss in take-home pay in those industries which had shortened the work week from 48 to 40 hours. The incentive for industry to shorten the work week, of course, was to avoid the penalty overtime rate of time and one-half for all hours worked over 40 per week.

The basis for the new wage demands of organized labor was thus shifted to industry's ability to pay. (The wage reopening clauses in most wartime contracts, contingent upon a change in national wage stabilization policy, made it possible for most unions to press for immediate wage increases without waiting for contract terminations.) The ability of industry to pay was not a wartime yardstick for wage rate adjustments. For this fact there were several reasons. In the first place, a large number of industries operated during the war on a cost-plus-a-fixed-fee basis under government contracts. Obviously, a plea of inability to pay wage increases under these conditions would have been insupportable. In the second place, the exigencies of a tight labor market coupled with a greatly expanded demand for the good or service, even though not produced under government contract, caused the ability-to-pay yardstick either to be eliminated entirely or thrust far into the background in wage disputes. And finally, the limitations of the wage stabilization program made

the plea of inability to pay on the part of industry unnecessary in considering wage increases during the war. But after V-J Day all this was changed, and the ability of industry to pay became the prime issue in the consideration of demands for wage increases.

Labor stressed at least five points in support of its contention that industry had a greatly expanded ability to pay sizable wage increases in the reconversion or postwar period. First, it stressed the large wartime profits of industry as evidenced by the large reserves built up during the war, even after taxes. Although the size of these profits could easily be exaggerated, it was scarcely deniable that industry in general did prosper greatly as a result of its wartime operations. Second, labor insisted that the tremendous technological changes and improvements achieved during the war had greatly reduced costs of production and increased the ability of industry to pay. Third, and partly a result of the improvements in technology, the greatly increased efficiency of labor had widened the gap between labor's wage and its value productivity. Labor felt that the wartime restraints upon wage increases were also partly responsible for this widened gap. The claim of increased labor productivity has been rather clearly substantiated by various studies of the United States Bureau of Labor Statistics on labor's value productivity during the war. Fourth, labor based its contention of an increased ability of industry to pay on an expected large volume of production in the postwar period with a consequent reduction in unit costs. This obviously depended upon a number of unknown factors such as the size of the market, the degree of competition, governmental policies, etc. And lastly, labor pointed to the savings in overtime pay realized by industry in shifting back to a 40-hour work week.

Notwithstanding the merits of at least some of these arguments, some industries, for example, General Motors, rejected sharply the use of the ability-to-pay yardstick in the consideration of wage increase demands, while others insisted they could not meet increased wage demands under existing price ceilings. At all events this impasse culminated in a general breakdown of collective bargaining in the major mass production industries of oil, automobiles, steel, electrical products, meat packing, farm equipment, and transportation. As the nation's reconversion program ground to a halt in these industries, and the effects of these stoppages spread to related industries, the President was forced to revise his post-V-J-Day wage-price policy.

### The New Wage-Price Policy

The failures of governmental fact-finding boards to bring an end to the widespread work stoppages in the mass production industries, coupled with Congressional reluctance to support fact-finding as a formula for postwar industrial peace, provided the finishing touches to the decision of the Administration to announce a new wage-price policy for the reconversion period.

This new policy was issued in the form of an Executive Order on February 14, 1946. A somewhat detailed examination of this Executive Order is necessary in order to understand the breadth and importance of the changes in Administration policy contained therein.

In a statement released with the new Executive Order, the President made a frank admission that the sudden abandonment of wage controls last August and the return of the whole field of wage adjustments to free collective bargaining was a mistake. The new wage-price policy re-establishes wage controls and concentrates the widest power and authority over wage and price increases in the Office of the Economic Stabilization Director. Only one type of wage increases may now be made without the approval of the National Wage Stabilization Board or the Economic Stabilization Director,[1] to wit, those in which no price relief is requested as a result of the wage increase *and* in which the amount of the increase is not deemed to be unstabilizing or inflationary by the Economic Stabilization Director. All wage increases that will be used as a basis for requesting price relief must be approved by the Wage Stabilization Board.

Four yardsticks are established by this new Executive Order by which the Wage Stabilization Board will judge the permissibility of wage increases involving price relief. First, the increase must be consistent with the general pattern of wage adjustments made in the industry or local labor market area since August 18, 1945. This is the new yardstick and will be the basis for most petitions to the Wage Stabilization Board for approval of wage increase-price relief cases. Second, a wage increase may be approved by the Board if it is necessary to correct gross inequities between related industries, plants, or job classifications. Third, a wage increase may be approved to eliminate substandards of living. The Wage Stabilization Board has been approving wage increases up to 65 cents an hour on this basis. And last, a wage increase will be approved by the Board to correct a maladjustment between wage rates and the cost of living. Here the Board has been using 33 per cent as the correctional factor on the assumption of a cost of living increase of 33 per cent between January 1, 1941, and September, 1945. In other words, the Board will approve wage rate increases up to 33 per cent over January, 1941, to compensate for cost-of-living increases.

In addition to the above yardsticks, all wage increases recommended by government fact-finding boards before February 14, 1946, are specifically approved by this Executive Order, and such increases may be used as a basis for seeking price relief. This means that the increases recommended by fact-find-

[1] The National Wage Stabilization Board is the successor to the National War Labor Board. It is tripartite in make-up with two public, two labor, and two industry representatives. It has no jurisdiction over labor disputes; its sole function is to pass on the permissibility of certain types of wage increases or decreases.

ing boards for the automobile, steel, oil, and meat packing industries are automatically approved. But all future increases recommended by fact-finding boards or arbitration awards must be in accordance with the above yardsticks if price relief is requested.

In view of the general wage increases granted by industry since V-J Day (approximately 15 per cent), and the recently recommended or accepted increases in the oil, automobile, steel, and meat packing industries, the new wage policy in effect establishes a wage level for the reconversion period approximately 17 to 18 per cent above the level prevailing on V-J Day.

### Will This New Wage Level Necessarily Mean Inflation?

This new postwar wage level, however, will not necessarily result in a general breakdown of price controls. There is no provision in the new Executive Order for general or blanket price increases. Individual requests for price relief will be considered and decided by the Office of Price Administration on their own merits. An approved wage increase is no guarantee of a price increase to the company involved. If the Office of Price Administration finds that a business concern can match its base-period return with the approved wage increase, no price relief will be granted. The new Order provides that business concerns do not have to wait six months for OPA consideration of the effects of a wage increase on profits, but such concerns must show that, with the approved wage increase, they cannot meet the average rate of return on their net worth in their prewar base period. (This base period for most concerns is 1936-1939.)

Furthermore, increased wages will not necessarily mean higher cost of production to all concerns. High wages are not incompatible with low unit costs of production in many industries, as the automobile industry demonstrated in the prewar years. Whether or not higher wages will result in higher costs of production depends upon (1) the proportion of wage costs to total costs; (2) the effect of higher wages upon labor's productivity; and (3) the effect of higher wages upon managerial efficiency. If wage costs represent a relatively small proportion of total costs, higher wages may mean only insignificant increases in total costs. If labor's productivity increased proportionally with higher wage rates, unit labor costs would not increase at all. And if management is stimulated by higher wages to accelerate the introduction of technological changes in production, nonwage cost reductions might easily offset the effects of increased wages. The point is that higher wages do not *necessarily* mean higher unit costs of production to all concerns, and therefore inevitably higher prices to consumers.

Considering wages as a distributive share of the national income, the higher wage bill will not put undue pressure on prices from the demand side of the market if these higher wages are matched by an equal or greater increase in the production of consumer goods.

### Will the New Wage-Price Policy Insure Industrial Peace for the Reconversion Period?

The new wage-price policy will undoubtedly reduce the number of strikes and work stoppages during the reconversion period as the result of the deadlock over the wage issue. Furthermore, the new policy will probably promote industrial peace for at least part of the reconversion period by providing some standard or pattern for negotiation of the wage issue. This policy should also place some restraints upon extreme wage demands by organized labor and lessen the rigid resistance of employers to wage increase demands. There are not likely to be many demands, for example, for a 30 per cent wage increase under this wage policy. The authority of the Economic Stabilization Director to declare unstabilizing and inflationary wage increases unlawful, independent of price relief requests, will greatly reduce the tendency of organized workers to present their employers with extreme wage demands. But no one should be so optimistic as to believe that there will be no more serious work stoppages during the reconversion period. There will be heavy pressure by unions to get industry to grant wage increases without requesting price relief, and some fairly serious disputes may arise in this connection. Furthermore, the effect of this new wage-price policy upon industrial peace and high production during reconversion depends in large measure upon how rigidly it is administered. A strict definition of "industry or local labor market pattern" and of "unlawful" wage increases could bring on another series of work stoppages. With the admittedly drastic powers over wages and prices placed in the hands of Mr. Bowles and Mr. Porter by this Order, however, primary reliance must be placed on these "tough" administrators to hold the line in the public interest.

Even if the new wage policy exceeded the most optimistic hopes of its sponsors and eliminated entirely the wage issue as a source of industrial conflict during the reconversion period, there are numerous other unresolved issues in the present industrial relations picture. Maintenance of union membership as a peacetime industrial relations policy is still bitterly contested by many employers. Seniority problems, downgrading and reclassifications, jurisdictional disputes, accumulated grievances over working rules and conditions — all these problems represent a threat to industrial peace and a challenge to labor and management to settle them peacefully around the conference table. A high order of industrial relations statesmanship will be required to meet this challenge.

# Some Implications of Our Growing Public Debt

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At the beginning of 1946 the gross Federal debt exceeded 275 billion dollars. The debt was ten times greater than the Federal debt at the end of World War I and more than five times as large as the public debt in 1941. The ultimate size of the public debt will depend not only on the accumulated wartime governmental deficits, but also on the likelihood of continued peacetime governmental borrowing, so long as current revenues are inadequate to meet necessary governmental outlays. A balanced Federal budget is still a pious hope rather than a realized accomplishment.

Because of the magnitude of the sums involved an examination into both the wartime and the postwar economic implications of government borrowing seems timely and appropriate. The following discussion, however, relates primarily to governmental war financing with the aid of loan funds. It does not pertain to proposed peacetime deficit spending, aimed at achieving stable and high levels of employment. Wartime government expenditures, whether financed out of tax revenues or by borrowing, are incurred primarily to get possession of the goods needed to meet war requirements, either through purchase at open-market prices or at controlled prices. The wartime implications of borrowing rather than taxing to meet expanding public expenditures center largely around the effects of such borrowing upon the movements of prices. Wartime borrowing by the government may be either inflationary or non-inflationary, depending upon the source of loan funds, and the effect of their expenditure upon the physical volume of production. Inflationary borrowing tends to increase the money flow more rapidly than the counter flow of salable goods. In the absence of price controls this would tend to force prices upward. The existence of wartime price controls in a war economy may thus be viewed as evidence of potential price inflation. Price ceilings would obviously not be necessary if free market prices would not tend to rise above the ceilings.

But government borrowing for war financing may also be non-inflationary in nature. Such borrowing does not result in a net increase in the money flow, but merely diverts a part of the income stream from private channels into governmental channels. In proportion as civilians have less of their money left to spend by lending it to the government, the government will have more dollars to spend. An analysis of the several sources of loan funds

is thus needed to observe the likely effects of public borrowing for war financing.

### Sources of Government Borrowing to Aid in War Financing

The funds borrowed by the government may be either (1) transfer credit or (2) expansion credit. Loans made out of current or accumulated money incomes are in the nature of transfer credit, whereas loans of newly created funds are in the nature of expansion credit.

The government may borrow from individuals, business concerns, private investment institutions, public agencies, commercial banks, and Federal Reserve banks. During World War II, all these sources provided loan funds to the government. But the economic effects upon wartime prices and production of borrowing from these several sources were not necessarily the same.

**Borrowing from Individuals.** Individual investors in government bonds may purchase them with either current savings of income, idle bank deposits, or hoarded cash. Such investments represent transfer credit. The government gets the funds to spend, and the lender gives up his buying power by transferring it to the government. If the loans are made out of current incomes, which would otherwise have been invested in private enterprise or spent for current consumption, the physical supply of money will not be increased. The money stream will merely be given a different direction. But the economic effects of such diversion of buying power from individuals to the government are significant, for goods demanded by the government for war purposes are not necessarily the same as those that would have been demanded by individual savers or private borrowers. Short-run prices of essential war materials will tend to rise, whereas prices of various civilian goods will tend to decline. In the absence of government selective price controls, windfall profits will accrue to owners of materials demanded by the government, but losses will be incurred by those whose market has been narrowed because of the diversion of buying power. However, the general level of prices will not necessarily be forced upward by the extension of transfer credit to the government.

When individuals buy bonds with idle bank deposits or hoarded cash, they speed up the turnover of money, and thereby stimulate new investment or consumption demand, depending on the use the government makes of the borrowed funds. But the funds thus put into circulation represent the value of goods already produced, and not new funds or expansion credit. The expenditure of these formerly idle funds by the government will, however, tend to increase the velocity of money circulation, and thus may exert an upward pressure on prices.

**Borrowing from Business Concerns.** When business concerns invest in government bonds, they may pay for them out of net earnings,

Moreover, they may get the funds by liquidating inventory and not replacing it, or by skimping maintenance and replacement expenditures. In any case, private investment of funds will tend to be displaced by government investment. But the total money flow will not necessarily be increased by such purchases of war bonds. On the other hand, business concerns, even as individuals, may buy bonds with idle bank deposits, and thereby increase the velocity of money circulation.

**Borrowing from Institutions.** Private institutional investors, such as savings banks, trust companies, and insurance companies, ordinarily keep their excess funds invested. When they buy government bonds with their surpluses over current expenditures, which represent actual savings, they shift investments from private enterprise to public enterprise. This is a form of transfer credit. Whether it has also been expansion credit depends on the sources of the funds deposited by individuals with the investment institutions. The aggregate money flow will probably not be increased by such institutional investment in war bonds.

**Borrowing from Government Agencies.** Government agencies, such as the Social Security Board, may turn over their excess funds to the government by investing in war bonds. If they were to hold these funds as idle reserves, they would really be hoarding money, which would normally have a deflationary effect on prices. Since the funds lent to the government come from pay-roll taxes and other income deductions, the purchase of government bonds by public agencies does not put new money into circulation, but merely changes the direction of the money flow.

**Borrowing from Commercial Banks.** The government may also borrow directly from commercial banks. If investment in government securities by the banks were offset by a corresponding repayment of bank loans, such lending would not increase the physical supply of funds, and would, therefore, be non-expansionary in character. On the other hand, if banks increased their earning assets by purchasing government obligations, and sooner or later their deposits expanded as the government spent the loan funds, these loans would represent *expansion* credit, as distinct from *transfer* credit, as previously defined.

In this manner, new credit currency comes into circulation. If it is not accompanied by a corresponding expansion of production, prices will tend to rise, even though they may be held in check for the time being by hoarding the newly created funds. Expansion of commercial bank credit to finance war expenditures became a major cause of concern during World War II, because of its inflationary implications. In 1942 commercial banks in the United States increased their holdings of government securities by over 20 billion dollars. During 1943 a further 18.5 billion dollars was added to the holdings of Treasury bills, certificates, notes, and war

bonds in the investment portfolios of commercial banks. Their total holdings of government securities were increased by another 18 billion dollars in 1944, and by 12.4 billion dollars in 1945. Toward the close of the war, 85 billion dollars, or nearly 33 per cent of the Federal debt, was owed to commercial banks, exclusive of Federal Reserve banks.

**Borrowing from Federal Reserve Banks.** Open-market purchases of government securities by Federal Reserve banks are apt to be distinctly inflationary in character, particularly at a time when we have reached a high level of employment, as was the case in our economy during the latter part of 1941 and in the subsequent years of World War II. Any further expansion of the supply of credit currency under such conditions does not induce a corresponding counter volume of production, but merely tends to raise prices. During 1942 Federal Reserve banks increased their purchases of United States government securities in the open market by about three and a half billion dollars. Under the 1942 Amendment to the Federal Reserve Act, moreover, they were permitted to buy up to five billion dollars of government obligations directly from the United States Treasury. Toward the end of 1945, holdings of government securities by Federal Reserve banks totaled around 24 billion dollars, most of which matured in less than one year.

The table on page 30, based on Treasury Department estimates, shows the approximate distribution or ownership of the gross Federal debt as of September 30, 1945.

The possibilities of government "borrowing" by expanding credit currency are practically without limit. Since governments exercise legal power over the issue of credit currency, borrowing by governments could also take the form of issuing inconvertible paper currency, such as the Greenbacks of Civil War days. But the psychological effect of "printing-press" currency expansion upon public confidence in the government's policy has served as a deterrent from the outright issue of inconvertible currency. Instead our government has facilitated the expansion of bank credit currency to aid in war financing during World War II. In June, 1945, Congress authorized a reduction in the combined gold (certificate) reserve requirements of Federal Reserve banks from an average of 38 per cent against Federal Reserve Notes and deposits to 25 per cent, and made permanent the authority of Federal Reserve banks to use United States government obligations as collateral against Federal Reserve Notes. This action of Congress further extended the possibilities of bank credit expansion to meet currency requirements.

Federal Reserve funds released through purchase of government securities from either banks or bank customers, or directly from the United States Treasury, all tend to expand commercial bank deposits or "check book" money. This, in turn, makes it possible to increase member bank legal reserves, by

Ownership of Gross Federal Debt, September 30, 1945[a]
(Treasury Department estimates)

| | *Billions of Dollars* | *Per Cent of Total* |
|---|---|---|
| Individuals | 59.5 | 22.9 |
| Business Corporations and Associations | 28.9 | 11.1 |
| Institutions | 32.5 | 12.5 |
| Governmental Agencies (including state and local governments) | 32.1 | 12.3 |
| Commercial Banks | 83.7 | 32.2 |
| Federal Reserve Banks | 23.3 | 9.0 |
| Total | 260.0 | 100.0 |

[a] Adapted from *Treasury Bulletin*, February, 1946, p. 48.

placing part of the deposits entrusted to them with Federal Reserve banks of their respective districts. Against these additional reserves they can extend further credit as needed, since commercial banks operate on a fractional reserve basis, i.e., they are not required to hold a dollar in actual cash for every dollar of demand deposits. But through the purchase of government securities by the banking system, a large part of the public debt is monetized, i.e., converted into the equivalent of cash, since Federal Reserve funds can be obtained by commercial banks on these securities when needed, to meet depositors' demands for cash.

A study of the many-sided economic implications of wartime government borrowing thus requires careful inquiry into the sources of the funds lent to the government. In general, if they represent transfer funds or transfer credit, their use by the government will be offset by their nonuse by the savers, and so be non-inflationary in character. On the other hand, if the funds are in the nature of expansion credit, or new currency, they tend to become inflationary, unless accompanied by an expansion of production. Although there was a large margin of unused material and human resources in our economy prior to 1941-1942, new money flow, induced largely by commercial bank credit expansion, did not force the level of prices upward to any significant extent, for the physical volume of production was also expanding. From June, 1940, until April, 1941, total industrial production increased 20.5 per cent, whereas durable goods production rose 35.3 per cent and wholesale prices advanced only 5.2 per cent.

This situation changed rapidly as full normal employment was reached, while the demand for war output continued to expand. It was then, as previously noted, that expansion credit became a definite inflationary threat, for the money demand for salable goods was increasing more rapidly than the goods supply. In the absence of price controls, such increased money demand in the face of a relatively fixed supply of goods would cause prices to rise all along the line.

It should be borne in mind that the government is not limited to taxes and borrowing of current or accumulated money savings from individuals, business concerns, and institutional investors as sources of funds to buy the goods when needed for the war effort. In addition to tax revenues and transfer credit it can get the needed additional loan funds from commercial banks and Federal Reserve banks, if for one reason or another a sufficient volume of current money income and idle cash cannot be diverted to the public treasury to provide the required buying power. But, regardless of source, the funds are used by the government primarily to buy goods and services needed for war output. Expansionary or inflationary borrowing from commercial banks and Federal Reserve banks by the government is in reality a subtle form of compulsory saving or of concealed taxation. It takes away resources from individual owners and makes them available to the government. A simple hypothetical illustration will make this clear.

Assume that X has been earning a wage or salary of $3,000 a year, which measures the value of his production. He spends $2,400 annually for current consumption and saves $600. If the level of prices were to rise because of inflationary borrowing by the government, so that for the same quantity of civilian goods he had to pay $3,000 for which formerly he paid $2,400, while his money income did not increase, he would not be able to save any money, unless he were to lower his level of current consumption. If he produced as much as he did before prices advanced, he would now be consuming four-fifths of the value of his output even as he did formerly. The remaining one-fifth of his production would have been "saved," but neither voluntarily by him nor specifically for him. It would have been taken from him, and from others in the same position, through price inflation induced by expansionary or inflationary borrowing, and the government would have gotten it for use in the war effort, even as it might have gotten it either by actual taxation or by borrowing current money income. What the individual was thus forced to "save" through inflation, the government spent for war purposes. The nation, as a whole, however, was no wealthier because of this "compulsory thrift," for the savings were consumed in waging war.

Whereas compulsory saving in the form of payroll deductions, or withholding of incomes at the source, is apt to be non-inflationary, compulsory saving by means of currency expansion, whether in the form of printing-press money or bank credit, is inflationary borrowing. It adds to the money costs of the war if prices continue to rise. Moreover, it is the most inequitable form of compulsory saving, since it hits particularly those whose money incomes are relatively fixed, whereas all those whose incomes may be adjusted upward from time to time, to allow for changes in living costs with rising prices, will not be making their proportionate share of the real sacrifice required to wage

total war effectively. The need for wartime price controls and rationing under such circumstances becomes apparent, if a fair distribution of income is to be maintained.

### Postwar Implications of the Large Federal Debt

The dangers of price inflation in our postwar economy growing very largely out of inflationary wartime borrowing are even greater than those of inflation during the war, because of the accumulated "monetary spending power" in the hands of the public. Total money in circulation, which at the end of 1940 stood at 8.7 billion dollars, amounted to 27.94 billion dollars in February, 1946. This represented a 220 per cent increase in less than four years. Demand deposits of individuals, businesses, and institutions in commercial banks, exclusive of interbank and United States government deposits, rose from 32 billion dollars in June, 1940, to 77 billion dollars in January, 1946, or 141 per cent. Time deposits increased from 27.5 billion dollars in June, 1940, to 49.1 billion dollars in January, 1946, or 78 per cent. Series E Savings Bonds, redeemable on demand, which were in the hands of the people in December, 1945, had a maturity value of nearly 31 billion dollars, and a cash surrender value of over 22 billion dollars.

The highly liquid position of a substantial part of the Federal debt is the real inflation potential in the immediate future. It is reflected in the accompanying official compilation of business and personal liquid asset holdings in December, 1945.

The continuation of heavy wartime taxes, not merely to prevent the necessity of further deficit financing, but also to use some of the tax revenues to redeem maturing Treasury obligations, would be an anti-inflationary measure. But, as a matter of practical reality, 1946 taxes were reduced by nearly 6 billion dollars under the Revenue Act of 1945, avowedly to augment consumer buying power and to stimulate reconversion activity. The Victory Loan, floated in the fall of 1945, moreover, added a further 16 billion dollars to the Federal debt.

Furthermore, the demands of organized labor for upward adjustment of wages, to compensate for loss of income resulting from a return to the 40-hour work week and downgrading of jobs, were also fraught with inflationary possibilities. If the accumulated liquid business funds were to be partly drained to meet the demands for higher wages before peacetime production had expanded, further working capital or operating revenue would have to be obtained by business through credit expansion to finance production, unless businesses were able to obtain funds by raising prices over costs and thus increasing business profits. But once the spiral of higher wages, higher prices is generated, it will be exceedingly difficult to hold in check. If the "bulge" becomes big enough, there may be a "break-through."

Economists have for some time shown more concern over the likelihood of a postwar price boom, generated by the accumulated deferred spending power, rather than a post-

Estimated Liquid Asset Holdings, December, 1945[a]
(Business and Personal)
(In billions of dollars)

| | Business | Personal | Total |
|---|---|---|---|
| Currency | 4.9 | 21.1 | 26.0 |
| Demand Deposits | 37.8 | 23.6 | 61.4 |
| Time Deposits | 3.1 | 45.1 | 48.2 |
| Marketable U. S. Securities | 34.0 | 55.7 | 89.7 |
| Grand Total | 79.8 | 145.5 | 225.3 |

[a] Adapted from *Federal Reserve Bulletin*, February, 1946, p. 123.

war sudden deflationary collapse of prices. "By adding up the surplus liquid funds that consumers will have after the war, and taking account of the inevitable delays in reconverting industry to peacetime goods, it can in fact be shown that demand will so far outrun supply that the dangers of an inflationary boom are very real."[1] "In the reconversion period we shall be in the greatest danger of a violent postwar inflation if we do not continue the wartime controls," says Professor Alvin Hansen in the *News Letter on Economic Problems*. "On the one side there will be a great demand for consumers' durable goods, on the other side, it will take time before industry is retooled and equipped to produce these goods. In this interval demand will exceed supply, and the wartime price controls, including rationing, will be necessary to prevent chaos and inflation." "Price controls remain our only bulwark against inflation until production can increase sufficiently to balance demand," says the Director of War Mobilization and Reconstruction in his Report of January 1, 1946.

Public policy should thus be designed to emphasize the need for a continued postwar period of conservative and restrained spending, rather than to dramatize opportunities for deferred spending of wartime savings. If only 10 per cent of the 145 billion dollars of the liquid debt assets held by individuals were added to normal consumer spending out of current incomes in 1946, inflationary pressures would be greatly increased. By curbing too rapid spending of wartime accumulations, therefore, the threat of price inflation can be reduced. If price controls are relaxed too rapidly, the spurt in prices will soon become cumulative and induce a flight from money into goods. Once prices advance rapidly, the inducement to save and invest money is undermined, while velocity of money circulation is increased and the real buying power of money is diminished. If we would avert price inflation with all its resultant hardships, the volume of spending must not be permitted to outrun the supply of goods.

### The Problem of Servicing the Public Debt

Our postwar economy is poorer and not richer as a result of the war, not only because much of the war-

[1] *Fortune*, December, 1942, p. 2.

time capital produced is unsuited for peacetime production, but also because some of the existing capital was allowed to deteriorate during the war, because of inadequate wartime maintenance, improvement, and replacement. Nor should we overlook the destruction of human and material resources incident to waging total war. Service charges for the public debt represent claims against the income of a partly impoverished economic system. These claims are not related to any increased economic productivity, resulting from normal remunerative investment of savings. They must be met by levying against incomes, which, however, have not been produced by investment in the war effort. Debt-service payments thus mean a postwar redistribution of income, not according to the principle of productivity of capital investment, but according to the ownership of commercially unproductive investments. The owners of bonds have claims against the national income, which have to be paid by taking it from those who produce it, in our peacetime economy, and giving it to those who own the bonds. If the bondholders were also the producers of the income taxed away by the government to meet debt-service charges, in direct proportion to which they owned bonds, there would be no significant income redistribution resulting from such interest payments. But bondholders would then not be bearing their proportionate share of postwar current costs of government services.

There are two schools of thought as to the long-run significance of annual debt-service charges of possibly five to six billion dollars on a national debt of about 275 billion dollars. One school holds that so long as the Federal debt is an internal obligation, it is in essence owed by the people to the people. As previously indicated, if requirements for interest were met each year out of taxes collected from bondholders in the direct proportion to which they own government bonds, and the interest rate were uniform, this would obviously not affect the redistribution of the national income directly, aside from payment of debt-administration costs. It would be analogous to robbing Peter to pay Paul. If such a tax program were conceivable, it would serve to demonstrate the illusory nature of borrowing, rather than outright taxation, as an alleged method of shifting the real cost of the war onto the future.

"With efficient management, the public debt need cause no concern," says Alvin Hansen in the *News Letter* quoted above. "The public debt is not like a private debt. The taxes raised to pay interest charges are not thrown into the ocean. They are paid right back in the form of interest receipts by the bondholders.

* * * *

"Public debt neither increases nor lowers the national income but only affects the way in which the income is distributed. It is completely fallacious to look at the public debt purely from the standpoint of taxes while overlooking entirely the receipts of interest by the public gen-

erally — whether individuals or institutions from whose services the whole public is benefited.

"A widely distributed holding of government bonds after the war will be itself a factor guaranteeing security for the mass of the population. This is true since in depression years we can expect holders of bonds to cash them in order to sustain their necessary consumption."

It is doubtful whether this optimistic interpretation of the implications of our large national debt will meet with general acceptance. Since, as a matter of practical reality, taxpayers and bondholders are not necessarily identical, and because of the commercially unproductive nature of a large part of the wartime investments, there is also a school of thought which views the possible long-term postwar frictions that may grow out of our large national debt with considerable apprehension. If postwar normal Federal expenditures for governmental services, financed out of taxes, were to amount to upward of 12 billion dollars annually, as estimated by various authorities, while another five to six billion dollars had to be collected to pay interest on the public debt, the average Federal tax load borne by taxpayers would be increased over 30 per cent because of these debt-service charges. Such Federal taxes, even in peacetime, might not prove excessive and unduly burdensome, so long as the national income remained around one hundred and forty billion dollars at 1945 prices, but they would tend to become prohibitive in case of a major postwar depression and a substantial decline in the national income. The existence of the large national debt may thus be viewed as an important consideration in shaping Federal fiscal and economic policies designed to maintain a high stable level of national income and full productive employment, as well as a relatively high price level, as compared with the prewar level.

On the other hand, servicing a debt of $275 billions or more may restrict postwar government freedom of action in developing necessary public projects designed to aid in maintaining high levels of peacetime employment. If over 30 per cent of annual Federal tax revenues are currently absorbed by debt-service charges, it may become increasingly difficult to obtain popular approval of debt expansion to finance construction of public works, particularly in periods of declining business activity. Nor should we overlook the psychological reactions of taxpayers to the huge national debt. Taxpayers ordinarily do not relate tax payments to returns on investments, irrespective of whether these investments represent public or private obligations. To the average taxpayer all taxes appear burdensome, and resistances of pressure groups may create decided inequities as between taxpayers and bondholders.

Again, the incidence of postwar taxes to service the national debt must be carefully considered. If in the long run too heavy taxes were to be levied on current incomes, normally spent for civilian consumption, to meet debt-service charges, the resultant decreased demand for

consumers' goods might seriously affect the profitability of various business enterprises. If these concerns were also large government bondholders, receiving interest payments from the government, their investment returns might be maintained at the expense of their profits, because of the taxes imposed on consumer demand. In other words, what they and those similarly situated might be getting in interest on government bonds, they might in turn be losing in normal business profits. Under such circumstances, the taxes to meet debt-service charges would tend to fall, in part, on the creditors of the government, although levied primarily against consumer demand.

The nature of the tax program adopted by the government to service our huge national debt thus becomes an important factor in giving shape and direction to our postwar economy. Tax frictions tend to be accentuated not only by the increasing need for public revenue to meet the expanding functions of government but also to pay heavy debt-service charges incidental to carrying our large national debt.

### Debt Repayment and Long-Term Interest Rates

Traditionally it has been the policy of the Federal government to repay national debts growing out of war as speedily as possible. In 1836 the United States had practically no national debt, in spite of the public debts arising out of the Revolutionary War and the War of 1812-1814. Again the national debt, which at the close of the Civil War amounted to 2,845 million dollars, was reduced to 839 million dollars by 1893. Moreover, the public debt growing out of World War I, which totalled nearly 27 billion dollars in 1919, had been reduced to 16 billion dollars by the end of 1930.

But the magnitude of the public debt arising primarily out of the recent war precludes the likelihood of rapid debt retirement in the traditional sense. The debt may be wiped out, in part, through price inflation and be repaid with cheaper dollars, but this would not be real debt repayment. It would rather be a form of debt repudiation.

It has been facetiously remarked that the national debt will probably be repaid by never being paid. This paradoxical statement should not be interpreted to mean that the Federal government will wipe out the debt either by recourse to hyper-inflation or by default in meeting its contractual dollar obligations. It rather means that as one bond issue matures, it may be refunded with a new long-term issue, and eventually most of the outstanding bonds may be converted into perpetual annuities, even as some of the British consols outstanding since 1753 are such perpetual annuities. While some persons may want the face or capital value of their bonds to spend either for current consumption or for alternative investments, others seeking safe dollar investments for their savings may purchase the bonds in the open market. But the price at which such annuities will sell will depend on the postwar trend in long-term interest rates. A possible rise in such rates would

tend to lower the market value of the low-interest-bearing government bonds. If sufficiently extended, it might seriously impair public credit, and result in heavy losses to bondholders. To prevent such a possible decline in government bond prices, public policy would, in all probability, be designed to counteract any substantial upward trend in long-term interest rates. The easy-money policy which was pursued by the Federal government even before World War II would thus have to be continued in the postwar period. The strong demand for long-term low-interest-bearing government bonds would seem to indicate that investors expected the interest rate to remain low and possibly even to continue to decline. If, however, at any time the bondholding public should prefer to hold its "public debt" assets in the form of real assets or actual goods, any extension shift of assets would result in a decline of bond prices, i.e., a rise in interest rates, and it is questionable whether the government could prevent it. While the immediate inflationary threat grows out of the highly liquid nature of a substantial part of the public debt incident to "inflationary" wartime borrowing, the long-term consequences of the existence of the huge Federal debt must be related to possible tax frictions, rising interest rates, and resultant impairment of public credit reflected in a flight from legal claims to goods into actual goods.

There is always a possibility that long-run interest rates may rise. The destruction caused by the war, and the opportunities for investment in reconversion and reconstruction, at home and abroad, may exert an upward pressure on interest rates. In the face of such an eventuality, Federal Reserve banks will be relatively powerless to prevent losses to bondholders. Raising the interest rates by Federal Reserve banks to check credit expansion might cause financial embarrassment to the banking system in view of its large holdings of Federal securities. The selling of securities by Federal Reserve banks in the open market with a view to contracting bank credit would also tend to depress bond prices and spell losses to investors in government securities. On the other hand, continued open-market purchases by Federal Reserve banks to support the bond market would release further Federal Reserve funds, thereby increasing the inflation pressure, which might easily spell serious decline in the "buying power" of the public debt.

In the light of considerations such as these we can only hope that the holders of the public debt can be induced to exercise the necessary restraints in spending their wartime accumulated money savings. If this money is not to lose its buying power, it must be spent gradually over a long period of time and not until peacetime production has been expanded, industrial productivity has been stepped up considerably, and vigorous government economies and a balanced Federal budget have been attained. But judging from the conditions prevailing in this spring of 1946, the likelihood of realizing these objectives as possible inflation curbs is not very bright. To believe

that they may be attained in the not too distant future is at best to entertain a pious hope.

It is obviously impossible to predict, with any degree of certainty, just how and to what extent our large Federal debt will affect our postwar economy. Not only economic, but also political and psychological considerations enter into its evaluation. In view of the complexity of the many issues involved, the implications of the Federal debt promise to be a fruitful source of controversy and debate for years to come.

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**Liquid Savings of Individuals.** — The Securities and Exchange Commission recently disclosed that liquid savings of individuals in the year 1945 amounted to $37 billions. Savings were at the lowest rate since 1942; however, they were nine times as large as in 1940, the last full year before this country entered the war. In the latter part of 1945, there was a decline in the proportion of income saved. This decline primarily reflected increases in consumer expenditures, resulting from more ample civilian supplies and the lifting of various wartime controls.

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**Reconversion.** — Reconversion progress has exceeded all expectations and is a fine tribute to the vitality and resiliency of the American system. Despite strikes, the hampering influences of wage-price policies, and the like, national industrial production is still near the highest level in peacetime history. The Federal Reserve Board's index for February was about 54 per cent above the 1935-39 average. Prospects are that with the wave of strikes on the wane, industrial activity will be accelerated and may be in full swing by next autumn. — From *New England Letter* (First National Bank of Boston), March 29, 1946.

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**Increases in Basic Wages.** — Over-all data concerning the average increase since the end of the war in basic wage rates and the range by industry are not yet available. The United States Department of Labor has estimated that approximately 6 million workers — 20 per cent of all employees in private nonagricultural industry — received upward wage adjustments between the war's end and January 10, 1946, concentrated between 10 and 15 per cent. — From *Survey of Current Business,* March, 1946.

# The Bretton Woods Agreements

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The idea of an international central bank which will aid in general monetary stabilization and act as a clearing agency for the world is not new. Plans for this type of bank have appeared from time to time in financial history, but the difficulties of creating and operating such an institution delayed its formation.

The emergency in the world financial situation after World War I gave impetus to the formation of an international bank of limited nature.

### The Bank for International Settlements

The Bank for International Settlements (established by the Young plan at Basle, Switzerland, in 1930) was conceived as an agency which would eventually become a central banking institution for the world. The opposition of existing financial institutions and political controversy as to its location resulted in limiting materially the scope and functions of the bank.

At the outset the primary functions of this bank were to facilitate reparation payments. It acted as a trustee in receiving, administering, and distributing the annuities paid. The bank made advances to central banks, engaged in open-market operations in banker's bills, and purchased and sold foreign exchange. The bank could not make loans to governments, accept bills, issue notes, or own real estate aside from its place of business.

The breakdown in reparation payments seriously limited the activity of the bank and the breakdown in the gold standard rendered it almost helpless. But the bank was a center for information, for counsel, and for joint financial action until World War II.

### Monetary Stabilization Plans in 1943

The chaotic conditions of international finance during World War II and the difficulties of restoring world exchange stability in the postwar period have led to a number of proposals by businessmen, bankers, and economists for a strong international bank. The governments of the United States, Great Britain, and Canada all proposed plans for a world bank during the year 1943.

On April 7, 1943, the United States Treasury made public a circular called "Preliminary Draft of a Proposal for a United and Associated National Stabilization Fund." The American plan was presented by Dr. Harry D. White of the Treasury Department and has been called the "White Plan." On the next day the British government published proposals by British experts for an "International Clearing Union." The British plan was considered to be predominantly the work of John Maynard Keynes and

was called the "Keynes Plan." The Canadian government made public a "Tentative Draft Proposal of Canadian Experts for an International Exchange Union," on June 9, 1943. All these plans were similar in purpose and all proposed some form of international bank.

The United States preliminary draft was sent by the Secretary of the Treasury to the finance ministers of the United Nations and the countries associated with them with a request that it be studied by their technical experts. The finance ministers were also invited to send representatives to Washington for informal discussions with the Treasury representatives of this country.

Nearly thirty nations engaged in the informal discussions. At their conclusion, the experts of the Treasury department, with the co-operation of experts of other departments of this government, revised the preliminary proposal for an international stabilization fund and published the revised draft for "An International Stabilization Fund of the United and Associated Nations," on August 20, 1943.

### The Bretton Woods Agreements

Forty-four nations participated in the "United Nations Monetary and Financial Conference" at Bretton Woods, New Hampshire, from July 1 to July 22, 1944. This conference was called to formulate definite proposals for an international monetary fund and an international bank for reconstruction and development. The agreements reached at Bretton Woods provide for the establishment of two international financial institutions: first, "The International Monetary Fund"; and second, "The International Bank for Reconstruction and Development."

### The International Monetary Fund

The purposes of the International Monetary Fund were stated as follows:

1. To promote international monetary co-operation through a permanent institution.

2. To facilitate the expansion and balanced growth of international trade.

3. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

4. To assist in the establishment of multilateral systems of payments between members and in the elimination of foreign exchange restrictions.

5. To make the Fund's resources available to members in order to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

6. To shorten the duration and lessen the degree of disequilibrium in international balances of payments of members.

**Membership.** Practically all countries that wish to become members of the Fund may do so by meeting the terms presented. The original members shall be those represented at the Conference who sign the agreement.

**Quotas and Subscriptions.** Each nation shall be assigned a quota. The United States has the largest quota of $2,750,000,000; England's quota is $1,300,000,000, Russia's $1,200,000,000, France's $450,000,000, Canada's $300,000,000, and those of the other countries are in like proportion.

Each member pays 25 per cent of its quota in gold or 10 per cent of its net official holdings of gold and United States dollars whichever is the smaller. The balance of the quota is to be paid in its own currency. The quotas are definite and can not be changed without the consent of the member concerned.

**Par Values of Currencies.** The par value of each currency shall be expressed in gold or in United States dollars. The present United States dollar is 13.71 grains of gold. Since there are 480 grains of gold in an ounce, an ounce of gold is worth 480/13.71 or $35. If England maintains her £ at its present par value it would be worth $4.04 and would be equal to 54.39 grains of gold.

As each nation agrees upon the par value of its currency, its international payments will be paid at that value. As an illustration, when France became a member, she said that the franc would be worth 119 francs to the United States dollar, or .115 grains of gold. Then France will sell gold at that price or buy gold at that price. The franc would then be acceptable to all nations as worth .115 grains of gold, or .87 of one cent in United States money, and thus be stabilized in terms of all other nations which have set a par value in gold on their currencies.

A member can not propose a change in the par value of its currency except to correct a fundamental disequilibrium, and then only with the consent of the Fund. Minor changes aggregating 10 per cent may be made after consultation with the Fund. On all other changes the Fund may concur or object.

The total of all quotas is $8.8 billions, of which the United States will subscribe $2.75 billions, or 31.3 per cent. The estimated gold subscription of all the nations is $1.643 billions, of which the United States will subscribe $687.5 millions, or 23.8 per cent.

The gold of the Fund will be held in the central banks or other designated depositories of member countries. At the outset one-half of the Fund's gold will be held in the Federal Reserve System and 40 per cent in the central banks of Russia, the United Kingdom, France, and China.

The currency subscription of a member will be held in that country's central bank or designated depository.

**Transactions with the Fund.** Each member shall deal with the Fund only through its treasury, central bank, stabilization fund, or other similar fiscal agency. Each member can buy or exchange its currency with other members of the Fund. Any country can sell in any market newly produced gold from any mine within that country. A country may purchase gold from the Fund when its reserve is in excess of its quota. The Fund may charge

a service fee of ¾ of 1 per cent and may require a reasonable handling charge when buying or selling gold.

**Capital Transfers.** The nations may use the resources of the Fund for capital transactions of reasonable amount required for the expansion of exports or in the ordinary course of trade, banking, or other business, or to effect capital movements which are met out of a member's own resources of gold and foreign exchange, but such capital movement must be in accordance with the purposes of the Fund. A member can not use the Fund's resources to meet a large or sustained outflow of capital, and the Fund may request a member to exercise controls to prevent such use of the resources and may even declare a member ineligible to use the resources of the Fund.

**Scarce Currencies.** If the currency of a nation becomes scarce, the Fund may so inform members and may issue a report setting forth the causes of the scarcity and containing recommendations designed to bring it to an end. A representative of the member whose currency is involved shall participate in the preparation of the report.

**General Obligations of Members.** Members can not impose restrictions on the making of payments and transfers for current international transactions. No member shall engage in any discriminatory currency arrangements of multiple currency practice except as authorized by the Fund. Each member shall buy balances of its currency held by another member when their conversion is needed for making current transactions.

The Fund may require members to furnish it with such information as it deems necessary for the effective discharge of the Fund's duties. The required information may concern the nation's holdings of gold, its foreign exchange, gold production, gold imports and exports, total imports and exports of goods, capital transactions, price indices, international investments and obligations, and exchange controls.

**Status, Immunities, and Privileges.** In order to enable the Fund to fulfill its functions, it is to be accorded certain immunities and privileges in the territories of each member.

The Fund shall be free to contract, to acquire and dispose of property, and to institute legal proceedings. The Fund and its assets shall be free from taxation and customs duties.

**Relations with Other International Organizations.** The Fund shall co-operate within the terms of this agreement with any public international organizations having specialized responsibilities in related fields.

**Relations with Non-member Countries.** Each member undertakes not to co-operate with any non-member in any manner contrary to the provisions of the agreement.

**Organization and Management.** The Fund shall have a Board of Governors, Executive Directors, a Managing Director, and a staff.

The Board of Governors shall have all powers of control over the

Fund. Each member nation shall appoint one governor, who shall serve five years subject to the pleasure of the nation appointing him. The Board of Governors shall hold annual meetings and such other meetings as may be provided. Each governor shall be entitled to cast 250 votes plus one vote for each part of its quota equivalent to 100,000 United States dollars.

The voting power of the countries represented at the Bretton Woods Agreements would total 99,000 votes, of which the United States would have 27,750 votes, or 28 per cent; the United Kingdom, 13.4 per cent; Russia, 12.4 per cent; China, 5.8 per cent; France, 4.8 per cent; and the other 39 nations, 35.6 per cent.

There will be at least twelve Executive Directors, five appointed by the five members having the largest quotas, which at the outset will be the United States, the United Kingdom, Russia, China, and France. As other countries become members, the number of directors may be increased,

The Directors will conduct the general operations of the Fund. A Managing Director will be appointed by the Executive Directors, and he will have charge of the operating staff and will conduct the ordinary business of the Fund.

**Offices and Depositories.** The principal office of the Fund shall be located in the territory of the member having the largest quota (the United States), and agencies and branch offices may be established in the territories of other members.

The central bank of each member country or, if it has no central bank, any other institution acceptable to the Fund shall be designated as a depository for all the Fund's holdings of its currency. Each member guarantees all assets of the Fund against loss resulting from failure or default.

**Transitional Period.** The Fund is not intended to provide facilities for relief or reconstruction or to deal with international indebtedness arising out of war. Members may maintain and adapt to changing circumstances restrictions on payments and transfers for current international transactions, but shall take all possible measures to develop such commercial and financial arrangements with other members as will facilitate payments and the maintenance of exchange stability.

**Withdrawal of Membership.** Any member may withdraw from the Fund at any time by transmitting a notice in writing to the Fund at its principal office. Withdrawal shall become effective on the date such notice is received. When a member withdraws, normal transactions of the Fund shall cease and all accounts shall be made with reasonable dispatch. The Fund may declare a member ineligible if it fails to fulfill any of its obligations.

**Emergency Provisions.** The Executive Directors may, by unanimous vote, suspend the operations of the Fund for a period of not more than 120 days if an unforeseen emergency occurs. The Fund may not be liquidated except by decision of the Board of Governors.

**Amendments.** The Board of Governors must approve proposed

## THE INTERNATIONAL MONETARY FUND

Managing Director and Staff
Elected by the Directors

Executive Directors — 12
One each from Big Five
Seven elected by the Board of Governors

Board of Governors
One from each nation
Meets annually and at call of Directors

## THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

President and Staff
Elected by the Directors

Executive Directors — 12
One each from Big Five
Seven elected by Board of Governors

Board of Governors
One from each nation

amendments, and when three-fifths of the members having four-fifths of the total voting power have accepted the proposed amendment, the Fund shall certify the fact by formal communication to all members.

Unanimous acceptance is required to amend the sections applying to

(1) The right to withdraw,
(2) Changing a quota without the consent of that member,
(3) Changing the par value of a member's currency without its consent.

**Interpretation.** Questions of interpretation shall be submitted to the Executive Directors for their decision. Any member may require that the question be referred to the Board of Governors, whose decision shall be final.

**Final Provisions.** This agreement shall enter into force when it has been signed on behalf of governments having 65 per cent of the total of the quotas, but in no event before May 1, 1945.

When a government accepts membership, it shall transmit to the United States 1/100 of 1 per cent of its total subscription in gold or United States dollars for administrative expenses. Each nation shall become a member of the Fund when it has taken all steps necessary to enable it to carry out all its obligations.

Each member shall communicate the par value of its currency based on the rates of exchange prevailing on the sixtieth day before entry into this agreement. If the par value is unsatisfactory, the Fund and the member shall, in light of all relevant circumstances, agree upon a suitable par value.

Special provision and consideration is given to members whose territory has been occupied by the enemy.

### Advantages of the Fund to the United States

There are several reasons why the United States should be interested in the establishment of an international fund.

(1) It is to the advantage of the United States to aid in the stabilization of the currencies of other nations. Since this country will desire to export and import on a trade and not on a lend-lease basis from now on, exchange rates must be reasonably stabilized for all commercial nations. If the nations are allowed to depreciate their currencies at will in order to undersell on the world market, the export trade of the United States can not be maintained, and internal price deflation must follow. This will likely be followed by excessive tariff barriers, exchange restrictions, multiple currency practices, and trade agreements.

(2) One of the chief advantages of the Fund is that all nations will have rather accurate and timely knowledge of the flow of exchange of their own nation as well as that of all others. When many merchants are importing and exporting, individual banks do not have adequate information on the balance of payments. This is of special importance to the nations with limited gold reserves.

## Criticisms of the Bretton Woods Agreements

There seem to be few objections to the purposes and aims of the agreements by businessmen, bankers, politicians, or economists. Practically all agree that the revival and expansion of international trade is desirable and that relatively stable rates of exchange between currencies are necessary for orderly world trade, international investments, and world price stability.

The chief criticisms seem to be directed toward the complicated organization and procedure that is proposed for accomplishing these objectives, and to what extent the United States should go in subjecting national interests to international agreements.

Some of the criticisms that may be advanced against the Bretton Woods Agreements are:

(1) That a majority of the Board will be made up of debtors to the Bank who want to borrow money, whereas the lenders, not the borrowers, should control in a financial institution.

This criticism may have some validity, for the Bank will be controlled by a majority of the governors, but the good judgment of the directors should prevent loaning without adequate security. Also, the United States, which will be the chief lending but not a heavy borrowing nation, may withdraw from the Bank at any time there is evidence that good banking judgment will not prevail.

(2) That the Fund and the Bank may sacrifice too much of our national freedom in financial affairs. Mr. Morgenthau, Secretary of the Treasury, stated in his closing address to the conference that "there is a curious notion that the protection of national interest and the development of international co-operation are conflicting philosophies, that somehow or other men of different nations can not work together without sacrificing the interest of their particular nation. The American delegation which I have the honor of leading has been at all times conscious of its primary obligation — the protection of American interests, and the other representatives here have been no less loyal or devoted to the welfare of their own people."

(3) That the Fund will lead to inflationary tendencies in some countries by granting extensive credit. The major reason for creating the Fund should be to aid in stabilizing the currencies and credit in all nations and to prevent inflationary policies. Without agreements on currency and exchange stability, there is no limit to internal inflation and external depreciation. To believe that the Fund will cause inflation in some countries by the overextension of credit one must assume that the Directors of the Fund will be lacking in financial judgment.

(4) That the Fund does not make a sound use of gold as an international money.

The workings of the Fund and of the gold standard are similar. Each country ultimately must pay for its foreign purchases by the sale of its goods and services. Under the gold standard an unfavorable balance is

met by shipping gold or borrowing; under the Fund the gold is transferred or credits are negotiated just as under the gold standard. In both cases the unfavorable balance can be met for only a short time, and permanent solutions must be effected by a readjustment between imports and exports.

The major differences between the gold standard and the Fund are that exchange readjustment can be effected with the cooperation of the Fund and that exchange rates can be brought into orderly alignment without competitive depreciation. Under the gold standard a nation was free to leave, or might be forced from, the gold standard at any time and could then depreciate its currency for competitive trade advantages. Also, under the gold standard short-term borrowing was uncontrolled and hence subject to market conditions; under the Fund, borrowing is done with full information and with a surety of stable market facilities.

If the Fund is directed properly and can obtain the cooperation of the nations, the gold standard will be able to function to keep exchange rates reasonably stable and can probably more nearly prevent the gold standard from being unworkable during world economic depressions.

## International Bank for Reconstruction and Development

The International Bank for Reconstruction and Development was framed at the Bretton conference at the same time the Fund was created.

**Purposes of the Bank.** (1) To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including the restoration of economies destroyed or disrupted by war, the reconversion of productive facilities to peacetime needs, and the encouragement of the development of productive facilities and resources in less developed countries.

(2) To promote private foreign investment by means of guarantee or participation in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, funds from its own resources.

(3) To promote the long-range, balanced growth of international trade and the maintenance of equilibrium in balances of payment by encouraging international investments.

(4) To arrange the loans made and guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects will be dealt with first.

(5) To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and, in the immediate postwar years, to assist in bringing about a smooth transition from a wartime to a peacetime economy.

**Memberships in and Capital of the Bank.** The members of the Bank shall be the original members of the International Monetary Fund,

but other nations may join under terms prescribed by the Bank.

The authorized capital stock of the bank shall be 9.1 billions in terms of United States dollars of weight and fineness in effect on July 1, 1944, but only $1,820 millions will be paid in. The par value of each share is $100,000 and is available only to members.

Each member shall subscribe to the stock of the International Bank. The United States shall subscribe $3,175 millions (31.8 per cent), the United Kingdom $1,300 millions (13 per cent), Russia $1,200 millions (12 per cent), China $600 millions (6 per cent), France $450 millions (4.5 per cent), and other members the remainder.

Twenty per cent shall be paid in and 10 per cent shall be subject to call; eighty per cent shall be subject to call by the Bank only when required to meet losses. Two per cent shall be paid in gold or United States dollars when the Bank begins operations and 8 per cent in each member's currency within a year. Further subscription will be made only as needed.

**General Provisions Relating to Loans and Guarantees.** The Bank may make or facilitate loans in three ways. First, it may make direct loans out of its own funds; second, it may make loans out of funds borrowed from private investors in member countries; and third, it may guarantee either in whole or in part loans made by private investors through the usual investment channels. Total loans and guarantees shall not exceed the unimpaired capital, surplus, and reserves of the Bank. The Bank is to give special consideration to the devastated areas. The Bank will deal with members only through their treasurers, central banks, or other agencies.

The Bank can finance or aid in the financing of a project only if it is satisfied that the borrower, without its aid, would not be able to get loans on reasonable terms. It must give special attention to the prospects of the borrower's or guarantor's ability to meet its obligations.

**Operations.** The Bank may make direct loans out of its own funds from the 20 per cent subscribed for this purpose. The 2 per cent paid in gold can be used by the Bank for any purpose. The currency subscribed by a member can be loaned only after that member has passed on the loan. Repayments and payments of interest and commission must be made in currency equivalent to the dollar value at the time the loan was made.

The Bank, with the approval of the member in whose markets the funds are raised, may borrow funds to make direct loans. The borrowed funds can then be converted into other currencies or into gold and be loaned. In providing foreign exchange to a borrower, the Bank must give him the particular currencies he may require. It will not give the country dollars unless it needs dollars to spend in the United States. The borrower can not acquire currencies from the Bank for the purpose of selling them in the exchange markets for other currencies.

The Bank determines the interest rate, the amortization payments, the maturity, and the commission to be charged in connection with each direct loan. The charges and the repayment schedule must be reasonable and appropriate to the project financed.

Loans may be made by private investors through the usual investment channels and be guaranteed by the Bank. Loans guaranteed by the Bank must meet conditions similar to those of direct loans. The Bank must receive suitable compensation for its risks in guaranteeing loans. For the first 10 years the commission shall be between 1 and 1½ per cent; after ten years the commission may be lowered. All payments of commission to the Bank must be kept as a reserve.

**Organization and Management.** The Bank shall have a Board of Governors, Executive Directors, a President, and such other officers and staff to perform such duties as the Bank may determine.

All powers of the Bank are vested in the Board of Governors. The Board of Governors is elected in much the same manner as for the Fund. The voting power of the Board of the Bank is allocated as follows: the United States, 31.4 per cent; Great Britain, 13 per cent; Russia, 12 per cent; China, 6 per cent; France, 4.6 per cent; and the other members, 33 per cent.

There shall be twelve Executive Directors, who shall serve two years. Five Directors shall be selected by the five larger shareholders, and seven by the other members. The Directors shall function in continuous session at the principal office of the Bank.

The chief executive of the Bank will be a President, and the Bank will have an Advisory Council of seven members elected by the Board of Governors. This council will include representatives of banking, commercial, industrial, labor, and agricultural interests.

The principal office of the Bank will be located in the United States.

**Withdrawal and Suspension of Membership.** Any member may withdraw from the Bank at any time by transmitting a notice in writing, and the withdrawal becomes effective when such notice is received. Members may be suspended by a majority vote, and a suspended member is automatically forced to withdraw after a year, unless a majority vote decides otherwise. The technical and legal settlements of obligations are similar to the Fund requirements.

**Interpretation.** The Executive Directors shall make interpretations of the provisions between members and the Bank, and any member shall be entitled to representation. Any member may require that the Directors' decision be referred to the Board of Governors, whose decision shall be final.

**Final Provisions.** This agreement shall become effective when it has been signed by nations whose minimum subscriptions comprise 65 per cent of the total and when the deposits have been made, but in no event shall this agreement enter into force before May, 1945.

### Advantages of the International Bank for Reconstruction and Development

The devastated countries of Europe and Asia will be desperately in need of long-term financial aid for some time. Other nations which are not fully industrialized will desire some long-term credits.

The United States undoubtedly will be the leading financial nation in the world in the postwar period. Unless we extend credit upon a reasonable basis, most of these nations will not be able to borrow capital up to their full needs and potentialities.

Also, unless these credits are carefully supervised by agencies having full information of each nation's financial resources and responsibilities, imports and exports, capital needs, and ability and willingness to meet the amortization of these loans, we may over-loan some nations as we did in the twenties. Many banks in the United States failed in the thirties because of the poor investments that they made after World War I without adequate information and proper security.

### Criticisms of the International Bank

The first major criticism of the International Bank is that the borrowers will control the Bank and hence will loan without adequate security. This again is based upon the assumption that the Directors will be biased toward their own countries or will be incompetent. This may occur, but since the Board represents all nations it would require the collusion of a number of nations, and the United States can always withdraw if the Bank can not be operated upon sound financial policies.

A second criticism of the International Bank is that it is unnecessarily complicated in functions and operations. These same criticisms were leveled against the Federal Reserve System of this country. All institutions are likely to seem complicated until we become familiar with their functioning and accomplishments. The world may find that the Bank is impossible to operate with the many nations at the controls and that it has assumed greater functions than it can accomplish. But we have found that many of our institutions do meet the challenge of enlarged scope and operations.

All functions which it is proposed to delegate to the Fund and the Bank have been performed in the past by private agencies, such as the international bankers and speculators in foreign exchange and foreign securities. These agencies have independently hired experts and made investigations on international trade and financial matters. Our government, through the Commerce Department and the State Department, has rendered services wherever possible in obtaining information and good will for the development of foreign trade and investment.

Another criticism is that private bankers would be forced to compete with an international institution. This is true to a limited extent. Private international bankers will

not be able to control the flow of capital at will if the International Bank functions properly. They will not be in a position to direct loans to the markets that offer the highest commission and the highest interest rates. They will be able to loan freely to any nation if they so desire, but if that nation's credit is good it will pay only the commission and the rate of interest demanded by the International Bank. The investment banker will then be forced to loan at the International Bank rates or will be forced to take loans that the Bank refuses.

The International Bank will not restrict the investment opportunities of the private banks. The private banks may make loans just as they always have, and they will have information from the International Bank in addition to that of their own experts to guide them. The commissions and interest rates may not be so high as those prevailing after the last war, but loans should be safer for the investor and more in accordance with the actual needs of the borrower.

The smaller banks especially should be benefited, because they will have more information on foreign securities or may purchase the loans guaranteed by the International Bank. The volume of international investment which can be made on a firm financial basis should be increased if the Bank functions properly, because it will have information on the capital needs of every nation and on the security of that nation. When these loans are granted at a reasonable rate of interest and without the exorbitant commissions sometimes charged in the past, the volume of investment that the actual bondholder can make should be greater than could be expected without an international agency.

The International Bank will make loans only when such loans can not be made through normal investment channels at reasonable rates.

### Establishment of the International Institutions

The United States accepted membership in the Bretton Woods Agreements on July 31, 1945, the vote in the House being 345 to 18.

The President was empowered to appoint (with the advice and consent of the Senate) a Governor and an Executive Director to the Fund and also to the Bank. The act instructed the Federal Reserve Banks to act as depository or as fiscal agent when requested to do so.

The act stated that neither the President nor any person or agency of the United States shall request or consent to any change of quota or par value of the dollar, subscribe to any additional shares of stock, or make any loans to the Bank or Fund, without a law of Congress.

Of the forty-four governments which were eligible, thirty-three signed before the end of the year 1945, representing approximately 80 per cent of the total quotas. Russia, Australia, New Zealand, Venezuela, Haiti, El Salvador, Nicaragua, Panama, and Liberia did not accept the Bank or the Fund. Colombia signed the Fund but not the Bank agreement.

President Truman invited the

Board of Governors of the International Monetary Fund and of the International Bank to hold their first meetings beginning March 8, 1946, at Wilmington Island, near Savannah, Georgia. This was in accordance with the agreements which made it the function of the government having the largest subscription to call the first meeting. The nations which were eligible but which had not joined were invited to send observers. Russia sent an observer, but did not join the agreements.

After considerable discussion the salary of Executive Directors was fixed at $11,000 net of taxes. The managing Director of the Fund and the President of the Bank will receive $30,000 exclusive of taxes, and all member nations are to be requested to exempt from taxation all salaries and allowances paid by the Fund and the Bank.

Since only 38 nations had joined by March, 1946, the quota of the United States remains the same, but our percentage of total subscription in the Bank is 41.47, and in the Fund, 37.27; our voting power is 37.1 per cent in the Fund and 33.1 per cent in the Bank.

It has been reported that the United States had been asked to accept the Presidency of the Bank and the Managing Directorship of the Fund, but that the United States representatives have indicated a willingness to accept only the Presidency of the Bank.

Camille Gutt of Belgium was elected "Managing Director" of the Fund by unanimous vote of the twelve Executive Directors on May 6, 1946. Harry D. White of the Treasury Department has been appointed Executive Director of the Fund from the United States.

The Big Five—the United States, England, France, China, and India (at present taking the place of Russia) — were given Executive Directors in both the Fund and the Bank. Representatives from Brazil, Mexico, the Netherlands, Canada, Czechoslovakia, Belgium, and Egypt received the other seven executive directorships of the Fund; the Netherlands, Belgium, Chile, Poland, Cuba, Canada, and Greece received the other seven executive directorships of the Bank.

With the present membership, the Big Five will have 67.3 per cent of the voting power of the Executive Directors in the Fund and 71 per cent of the Bank's voting power.

### Problems of the Fund

The International Monetary Fund and the International Bank for Reconstruction and Development are expected to begin financial operations before the end of the year 1946.

The first problem of the Fund is to reach agreements on the par values of the currencies of members. When the Fund is ready to operate, it will notify the members and request each member to communicate the actual par value of its currency in terms of gold or United States dollars based on rates of exchange prevailing on October 27, 1945, sixty days before the Fund went into force. If during the 90-day period following the request neither the Fund nor the member objects to the communicated value, that

amount will become the initial par value for purposes of the Fund agreement. If either the Fund or the member nation objects to the value, agreement must be reached within a period determined by the Fund. Agreements on the par values of currencies will require several months, and the Fund will probably not be in a position to begin exchange transactions before the latter part of 1946.

The responsibilities of the Fund with respect to the elimination of exchange restrictions and discriminatory currency practices will be especially heavy in the first few years. When a nation becomes eligible to purchase foreign currencies from the Fund, it must decide whether it will take advantage of special transitional arrangements permitting the maintenance of existing exchange restrictions on current transactions or whether it will almost immediately eliminate all restrictions and discriminatory currency arrangements not authorized or approved by the Fund.

Under the transitional arrangements, each member promises to eliminate such exchange restrictions as soon as possible, and measures designed to encourage this will be brought into play at the end of three years and more strongly at the end of five years. In exceptional circumstances a member which persists in unnecessary restrictions may be declared ineligible to use the resources of the Fund.

The removal of restrictions by the United Kingdom is of great importance because of the unique position of England in world trade. The proposed loans by the United States and Canada are intended primarily to aid the United Kingdom in meeting the difficulties in her balance of trade; otherwise she can not eliminate exchange restrictions and discriminatory trade practices in the near future. These loans, of course, are not to be handled through the International Bank.

### Problems of the International Bank for Reconstruction and Development

The major function of the Bank is to promote the flow of international loans to meet the reconstruction and development of the war-ravaged countries. The Fund's loans will be for short terms to meet deficits in over-all balances of payment, whereas the Bank's loans will be long-term and for specific projects.

The Bank can make direct loans from its own funds or from borrowed funds, or by guaranteeing loans of private investors. Since the Bank's own funds from which it can make loans equal only one-fifth of the subscribed capital of the Bank, loans from borrowed funds or guaranteed loans of private investors will form the larger part of the Bank's operations. While the subscription of the United States is 41 per cent, the loans from all sources in the United States will be a much larger share of the total funds raised or guaranteed by the Bank.

The long-term capital needs of the world are sizable, and one of the initial problems of the Bank is to make loans or guarantee loans for the most useful and urgently needed

projects. Private investors will be encouraged to make loans to foreign nations at their own risk, but private banks will of necessity investigate carefully and approach foreign bonds with caution. Hence the Bank will be forced to make loans to the needy and to guarantee most of the immediate credit commitments.

The Export-Import Bank authorized loans totaling $1.5 billions in the last ten months and has authority to lend $1.5 billions more. This institution has no connection with the International Bank or the Fund.

The major portion of the obligations of the Bank will be sold in the United States commercial banks, and private investors will be the purchasers. Considering the time needed to investigate the credit needs of the nations and the time needed to arrange loans, the Bank can not begin operations for several months and may not reach large-scale operations before 1947.

### Outlook for International Monetary Stability

The International Monetary Fund and the International Bank for Reconstruction and Development have been created as permanent institutions and are expected to aid in the stabilization of world currencies and to arrange sound and orderly international loans in the immediate postwar period and thereafter.

The private banks and agencies have made great strides in the last three centuries in the development of world trade and international finance, but most authorities think that we should endeavor to set up some permanent institutions directed and controlled by international agreement. Considering the present state of world trade, world currencies, and world credit, there is good reason to believe that the new international institutions may be able to promote world trade, exchange stability, and sound international credit. In order to function successfully, the new institutions will need the co-operation and support of private banks, central banks, and the governments of the member nations.

If the International Monetary Fund and the International Bank for Reconstruction and Development prove to be successful in stabilizing the currencies of the nations of the world, in promoting world trade, and in directing capital to the nations for reconstruction and expansion on a sound basis, they will be strong forces for international political co-operation and for world peace.